RESEARCH REPORT
Kyiv Retail Market

CBRE | Ukraine
PART OF THE CBRE AFFILIATE NETWORK

www.cbre.ua

H1 2015

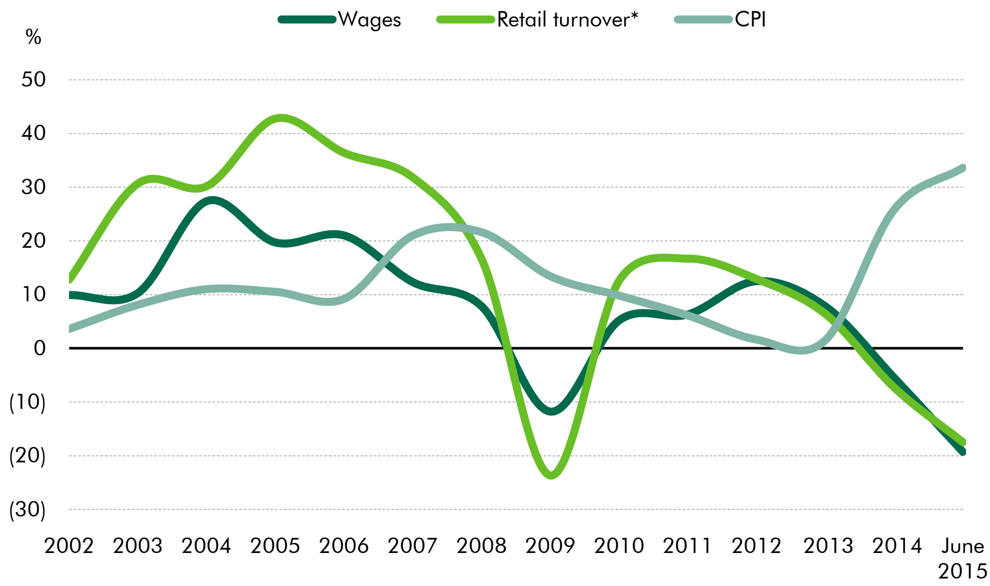
HOT TOPICS

- Limited occupier demand with retail turnover tumbling 17.5% y-o-y over H1 2015
- Absence of new supply accompanied by significant slowdown in construction pace
- Minor reduction in prime vacancy (-1pp) to 5%-7% owing to active rotation, while secondary indicator reached 10% -14%
- Rents under downward pressure: prime rents declined by 13%, with secondary rents recording 18% decline over the course of H1 2015

FUNDAMENTALS

The Ukrainian economy fell deeper into recession, with real GDP dropping by 17.2% y-o-y in Q1 2015. The negative dynamics across core sectors continued with an expectation to reach the bottom in Q2 2015. Annual real GDP is expected to contract by 8% - 10% in 2015 according to the forecasts by leading international and government organizations[1]. A marked decline is primarily a consequence of the conflict in the East of Ukraine intensified by an increasing pressure on Hryvnia and concerns over sovereign debt restructuring.

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



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

Retail sector demonstrated an abysmal performance on the back of depressed consumer demand: organized retail turnover shrank by 17.5% y-o-y in Kyiv, while deeper decline in sales was recorded at the national level (-25.1% y-o-y) during January – June 2015. Consumers were very selective in their purchases adjusting their spending habits to new circumstances. These patterns reflected a drastic reduction in real wages (-19.3% y-o-y) due to another devaluation spike in February, accompanied by significant rise in energy tariffs in April which altogether boosted inflation by +33.6% (CPI) by the end of June 2015 as compared to the end of 2014.

[1] - Ministry of Economic Development and Trade, NBU, IMF, EBRD, World Bank

© 2015, Expandia LLC

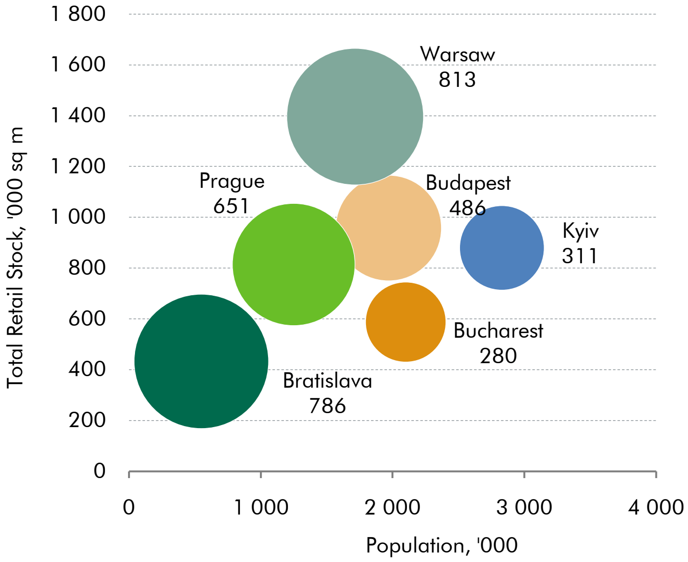
DEMAND

Retailers continued to focus their strategy on cost management with very limited number of openings in H1 2015. Food retailers considerably reduced expansion dynamics. Noteworthy is a large-scale opening of *Novus* hypermarket with the total area of ca. 20,000 sq m which took place on the Left (East) Bank of Kyiv in H1 2015. In addition, stronger players pursued expansion through acquisition of competitors' business or just secured leases of retail space previously occupied by a competitor. For instance, Fozzy Group announced the opening of *Silpo* hypermarket (8,000 sq m) in place of *Furshet Gurman* within Gulliver mixed-use prime scheme and a supermarket (800 sq m) in Komod SC. Furthermore, twenty *Amstor* supermarkets across the country (three of them in Kyiv) are scheduled to be replaced by *Silpo* in the nearest future in line with restructuring of the *Amstor* chain. Another prominent event was the acquisition of *Kraina* hypermarkets located in Magelan shopping centers in Kyiv and Kharkiv by the *Karavan* hypermarket chain.

Health&beauty was another segment relatively resistant to the economic downturn. Major retailers (*Watsons, Eva, Prostor, Kosmo*) continued to grow their market share and announced aggressive expansion plans for 2015. National health&beauty chains *Prostor* and *Eva* announced plans to expand their retail chains by 100 shops across the country over the year. *Watsons*, Asian drogerie retailer, announced similar target of additional 100 shops in 2015, which represents almost twofold increase in the number of new openings compared to 2014.

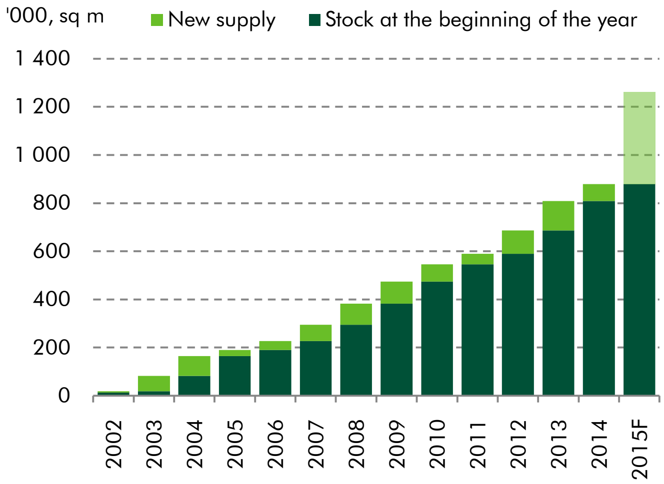
Fashion segment was most susceptible to consumer demand contraction, as consumers tended to tighten their belts and decrease spending on fashion goods. In general, occupier activity was mostly limited to closing nonperforming shops, downsizing space requirements and relocating to better performing shopping centers under more beneficial lease terms. At the same time some retailers embraced the opportunity to occupy larger units in the best locations pursuing long-term strategy. For example, Spanish retailer Punto FA after launching its new format *Mango Megastore* on Kreschatyk St. in 2014 opened the second store (2,500 sq m) within Ocean Plaza SEC in H1 2015. Turkish denim retailer Eroğlu (*Colin's, Loft*) also reassessed its space requirements increasing the average area of new *Colin's* stores from 500 sq m to 1,000 sq m. The first *Colin's* store of larger format was opened in Sky Mall SEC expanding the unit size from 400 sq m of the existing store. Whereas leasing larger units allows retailers to negotiate lower rents, the retailer has to be able to provide a wider selection of merchandize. Fashion retailers almost halted their expansion until the market revival, which is not expected at least until the end of 2015. The analogous "wait-and-see" approach is adopted by international retailers currently not present on the market. Only few new brands opened their first stores in Kyiv in H1 2015: Turkish mid-range fashion brand *ADL* opened two stores in Dream Town SEC and Piramida SC, Italian multibrand lingerie chain *Silenza* secured three locations in Kyiv shopping centers (Sky Mall, Dream Town, Prospekt), while the first store of German brand *Betty Barclay* was opened in Ocean Plaza. In the luxury fashion segment the first monobrand boutique of American high fashion house *Oscar de la Renta* opened its doors in Mandarin Plaza SC, as well as French luxury monobrand *Chloe* opened in Passage, Kyiv's luxury street retail destination.

RETAIL PREMISES PER 1,000 INHABITANTS IN SELECTED CEE CAPITALS IN H1 2015



Source: CBRE Ukraine

KYIV SHOPPING CENTER STOCK



F - forecast
Source: CBRE Ukraine

© 2015, Expandia LLC

SUPPLY

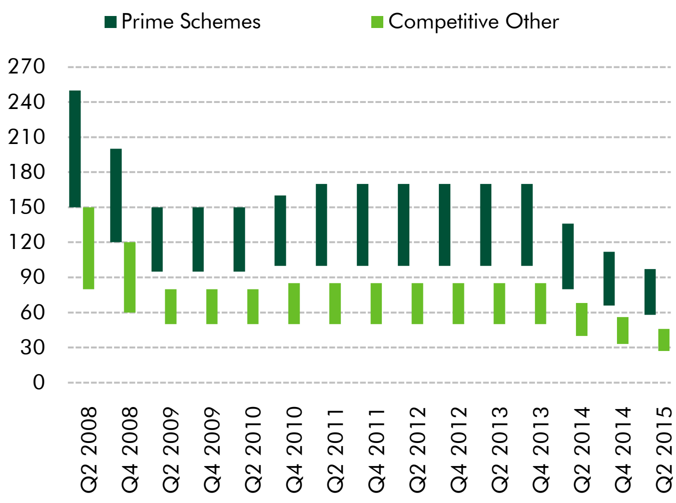
Notwithstanding high volume of retail space planned for completion, no new shopping centers were delivered during H1 2015. Total competitive stock of shopping centers remained unchanged at ca. 880,000 sq m, and provision of retail space stood at 311 sq m per 1,000 ppl. The trend corresponds well to depressed consumer spending and weak retailer demand. With occupiers nearly freezing expansion, the pace of leasing campaigns slowed down remarkably. Such situation was most acute for shopping centers on the final stage of construction. For instance, the opening of Respublika SEC (135,000 sq m GLA), previously expected to be completed over H1 2015, was further postponed with a new delivery date to be announced in September. Works on the center were halted with approximately 6 months until completion.

The market peculiarity of the current crisis is that declared pipeline volumes remained high, even though construction works were very inactive and the construction pace decelerated. Currently around 380,000 sq m of modern retail space is announced for delivery by the end of the year within five schemes, while in fact only 6% of that volume is likely to be delivered in time. Developers of additional three shopping centers with the total GLA of 150,000 sq m announced their openings in 2016. The reality, however, is that given pace of construction and retailer demand, completion dates of the majority of schemes are likely to be pushed back 2-3 years. One other particularly strong development constraint is virtual unavailability of borrowed long term finance, which is particularly applicable to schemes at early construction stages.

VACANCY & RENTS

Notwithstanding a stagnant demand from retailers, active rotation campaigns undertaken by landlords supported by the absence of new supply fostered a slight decline in prime vacancy (-1 pp) over H1 2015. As a result, availability in prime shopping centers stood in the 5%-7% range as of the end of June 2015. This trend was largely supported by the shift in retailer focus to prime properties. Moreover currently is the right time to secure retail premises in the most sought-after shopping centers under tenant market conditions. At the same time the consolidation and flight-to-quality retailer strategies while helping maintain prime occupancy had a negative effect on the secondary shopping centers where vacancy reached 10%-14% as of the end of H12015.

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



Source: CBRE Ukraine

KEY SHOPPING CENTERS IN PIPELINE AS OF Q2 2015

NAME	Developer	GLA, sq m	ANNOUNCED DELIVERY
Respublika	K.A.N. Development	135,000	H2 2015
Lavina	Mandarin Plaza/KSS	125,000	H2 2015
Blockbuster Mall	Mandarin Plaza	100,000	H2 2015
New Life (New Way)	Local developer	16,000	H2 2015
Manufactura (outlet centre) Phase II	ADS	6,600	H2 2015
TSUM	Esta Holding	22,500	H2 2016
Lukyanivka	Arricano Real Estate	47,000	H2 2016
Retroville	Stolitsa Group	80,400	H2 2016

Source: CBRE Ukraine

© 2015, Expandia LLC

As rental rates were heavily exposed to currency value fluctuations, retail rents displayed a further substantial reduction in dollar terms in view of a particularly steep UAH drop in Q1 2015. The pace of rental value decline eased as the year progressed. USD-based rental rates for prime retail properties declined by 13% over H1 2015 ranging between $58 - $97/sq m/month (triple net) for typical gallery units of 100-200 sq m. Meanwhile, there was a continued downward pressure on rents for properties deemed secondary in terms of location and quality. Rents for secondary shopping centers suffered approximately 18% decrease and varied in the $27- $46 sq m/month range. In general, both sides were willing to negotiate short term rent reduction, with tenants locking in to predictable UAH rent and landlords having to budge to stronger tenants in view to maintaining tenant mix and long term cashflow. Such short term concessions took forms of % discounts, temporary fixation of the UAH/USD exchange rate or minimal rent, as well as converting a larger portion of fixed rent to a turnover based rent. Particularly incentive rich are shopping centers currently under construction, with developers having to cover the fit-out costs for the most welcome occupiers in order to secure the desired tenant mix. Such practice translates into substantially increased construction costs and pay back periods, as the typical anchor occupier fit-out tax falls in the $500 to $1,000 per square meter range.

YIELDS

Economic recession coupled with geopolitical tensions had significant negative repercussions on the investment climate in Ukraine. Moreover, the virtual absence of debt financing and exchange rate volatility prevented the recovery in investment activity. Thus no pure investment transactions took place during H1 2015. The only registered transaction was a distressed asset sale of the secondary SC Kvadrat Perova (GLA 19,000 sq m). The heavily leveraged property by its previous owner XXI Century Investments was sold to local Petricol Investments. Transaction details are not available.

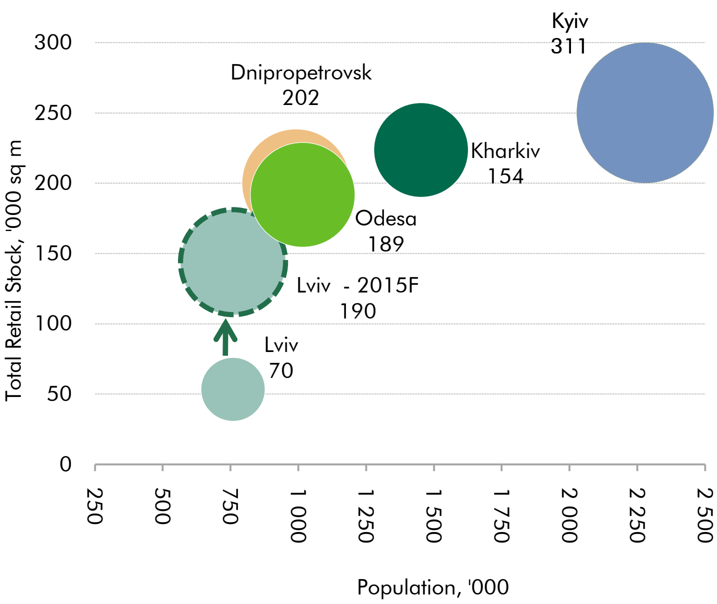
While the investment market did not experienced any tangible changes, the estimated prime notional yield for the highest quality retail assets stood flat at 13.5% as of the end of H1 2015. The odds are that prime yields will preserve stability by the end of 2015 under the conditions of no further major swings on the market.

REGIONS

While the economic turmoil haunts the market performance across the board, regional retail fundamentals felt even larger negative impact compared to the capital city. This is mostly attributed to the fact that population with relatively lower income in the regional cities experienced a substantially more painful effect to the disposable income. Nationwide, real wages plunged by 23.9% y-o-y during H1 2015. Ultimately, consumers were spending less: retail turnover decelerated by 25.1% y-o-y over January - June 2015.

Occupier demand reflected a noticeable decline in consumer spending power. As a result, majority of retailers were reluctant to commit to new space in regional cities, at least until the time when signs of improvement in market fundamentals can be seen. At the same time, geopolitical tensions posed additional risks in the Eastern part of the country thus shifting interest towards central and western Ukraine. *Auchan* discontinued the operation of their hypermarket near Donetsk region in December 2014 and announced plans to open a smaller new format (of 5,000 sq m) supermarket within Unicenter SC in Lviv. *Comfy* electronics retailer was forced to close 20 stores in occupied territories, while 14 stores were opened in central and western regions during H12015. *Comfy* also decided to reduce the standard space of one store from 2,000 sq m to 1,000 – 1,200 sq m for large cities, smaller format stores (500 sq m) are planned to be opened in 2nd tier cities. The Danish home appliances retailer *JYSK Holding* opened its first store (800 sq m) in Ivano-Franskivsk's SC Panorama and the second store (850 sq m) within semi-professional VAM SC in Lviv.

RETAIL PREMISES PER 1,000 INHABITANTS IN UKRAINIAN LARGEST CITIES IN H1 2015



Source: CBRE Ukraine

© 2015, Expandia LLC

KEY RETAIL SCHEMES IN 2015-2017 IN UKRAINE

NAME	CITY	DEVELOPER	GLA, sq m	COMPLETION/ ANNOUNCED DELIVERY
Forum Lviv	Lviv	Multi Development/Bud House Group	36,000	H2 2015
Victoria Gardens (Leopolis)	Lviv	Local developer	54,500	H2 2015
Hollywood Mall	Chernihiv	Local developer	43,000	H2 2015
Nikolskyi	Kharkiv	Bud House Group	52,000	2016-2017
Yessa (Zebra)	Odesa	Bud House Group	39,000	2016-2017

Source: CBRE Ukraine

Indeed, retailers were extremely selective in their lease decisions and focused only on the well-functioning shopping centers. In the fashion segment, *Gloria Jeans* opened its largest store (1,200 sq m) in Karavan SEC in Dnipropetrovsk. Another retailer committing to large-scale units was *Megasport*, a multibrand sports chain, opening 1,200 sq m store in King Cross Leopolis SEC in Lviv. Smaller stores around 350-400 sq m opened in 2nd tier provincial towns of Rivne and Poltava. LPP SA, Polish midrange fashion retailer, generally halted its expansion plans in Ukraine. However, earlier planned openings of their entire store portfolio (*Reserved, Sinsay, House, Cropp Town, Mohito*) will take place in Forum Lviv SEC soon. Moreover, Forum Lviv will welcome a remarkable opening of 6 brand stores (*Zara, Bershka, Pull&Bear, Stradivarius, Oysho, Massimo Dutti*) of the Spanish Inditex Group leasing around 5,000 sq m.

Construction activity slowed down considerably with no professional shopping centers delivered year-to-date. So far annual new supply of quality retail space is forecast to reach 133,500 sq m within three quality shopping centers, which represents a minor decrease (-6% y-o-y) in new additions compared to 2014. Notably, two out of three schemes are located in Lviv, including Forum Lviv (36,000 sq m GLA) and Victoria Gardens (54,500 sq m GLA). This may illustrate shift in developers' interest towards region with lower retail space saturation, favorable demographic characteristics and remoteness from the Easter conflict zone. With delivery of these two schemes, the provision rate of professional retail space in Lviv will grow from 70 sq m to 190 sq m per 1,000 ppl. Another remarkable scheme under construction is Hollywood Mall (43,000 sq m GLA) located in Chernihiv, smaller 2nd tier city with the population of ca. 300,000. At the same time, deliveries of Kharkiv's landmark shopping center Nikolskyi (52,000 sq m GLA) and Yessa shopping center (39,000 sq m GLA) in Odesa suburb were postponed at least until 2016 and will likely be shifted further.

OUTLOOK

The Ukrainian economy will continue to struggle with a recession until the end of 2015, while consumers will be facing low purchasing power undermining the recovery of consumer demand. In the absence of strong economic stimulus on the horizon, retail occupier market is expected to display similar trends to those observed in the first six months: generally subdued retailers activity reflecting continued concerns over demand prospects and cost management, with particular unwillingness to open new stores.

On the supply side, a large volume of retail space (380,000 sq m GLA) is announced for delivery during 2015. Our expectations are, however, that only ca. 6% of that volume will transfer into actual openings by the end of 2015. The balance will be slowly delivering over 2016-2018, with some of it possibly staying unfinished even longer. At the same time even this small volume of delivery implies a steady rise in competition among shopping centers in the nearest future. In the highly theoretical case of delivery of the entire volume of retail space currently planned for 2015-2016, 531,000 sq m will be released to the market, increasing market's size by 60% and bringing the provision of retail space to 500 sq m, up from 311 sq m per 1,000 ppl. Furthermore, a number of projects are currently on the stage of planning and concept design, including Ocean Mall (previously Phase II of the existing Ocean Plaza), Hartz mixed-use center, Kideal shopping center and others. Geographically, the future project pipeline is concentrated purely on the Right (West) bank of Kyiv, whilst the Left (East) bank remains unsaturated in terms of quality retail space. One the one hand, a huge pipeline of retail properties must be pegged on strong economic growth and healthy demand to support such supply dynamics. In the absence of such fundamentals, materialization of these projects remains a distant possibility. On the other hand, in order to compete with the existing supply, new shopping centers will have to possess and offer unique fresh ideas and experiences to lure tenants and consumers.

© 2015, Expandia LLC

In spite of generally subdued demand-side outlook, prime vacancy is expected to stabilize at the level seen at the end of H12015, as retailers are heavily concentrating on quality schemes and close underperforming units elsewhere. Secondary stock is in double jeopardy, as even the small amount of new supply will sap tenants and consumers away further increasing vacancy and decreasing rents. The magnitude of possible increase in secondary vacancy will depend on the actual volume of new additions. In the same vein, prime rents are expected to remain virtually stable, unless currency value repeats wild fluctuations of Q1. At any rate, the polarization trend between prime and secondary properties will be a prominent feature of the near future Kyiv retail market, especially under conditions of substantial supply growth over 2015-2017.

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.

For more information regarding the Market Review, please contact:

CONTACTS

CBRE | Ukraine
Expandia LLC
4 M. Hrinchenka St.,
Kyiv 03680
t: +38-044-390-00-00
e: ukraine@cbre.ua

Sergiy Sergiyenko
Managing Partner
e: sergiy.sergiyenko@cbre.ua

Maryna Gavrylenko
Head of Research
e: maryna.gavrylenko@cbre.ua

Kira Pruglo
Consultant
e: kira.pruglo@cbre.ua

DISCLAIMER 2015 CBRE

Information herein has been obtained from sources believed to be reliable. While we do not doubt its accuracy, we have not verified it and make no guarantee, warranty or representation about it. It is your responsibility to independently confirm its accuracy and completeness. Any projections, opinions, assumptions or estimates used are for example only and do not represent the current or future performance of the market. This information is designed exclusively for use by Expandia LLC|Part of the CBRE affiliate network clients, and cannot be reproduced without prior written permission of Expandia LLC|Part of the CBRE affiliate network .

© Copyright 2015 Expandia LLC|Part of the CBRE affiliate network

© 2015, Expandia LLC