

### HOT TOPICS

- Absence of new speculative supply, with construction for owner-occupation gaining momentum
- Weak demand driven mostly by relocations and contraction of occupied space: take-up amounted to 46,000 sq m (-14.8% y-o-y)
- Gradually rising vacancy: average vacancy rate reached 17.1% (+2.2 pp from Q4 2014) during the first six months of 2015
- Decelerating rents mostly due to national currency depreciation: prime base rents for A class warehouse space declined by 10% from \$5.0/sq m/month to \$4.5/sq m/month

### FUNDAMENTALS

Ukrainian economy slowed sharply in H1 2015: real GDP posted 17.2%<sup>1</sup> y-o-y drop in Q1 2015, with indicator falling further albeit at a slower pace (-14.7% y-o-y) in Q2 2015. Such weak economic parameters translated into a sharp deceleration of output in core sectors. Owing to continued contraction of industrial production, construction, as well as wholesale and retail trade, the industrial production index displayed a severe decline of 19.0% y-o-y during January – June 2015. According to the macroeconomic forecast by leading international and government organizations, the annual GDP is forecast to drop by 8 – 10%. At the same time the outlook for 2016 is more optimistic: the economy is expected to return to a moderate growth of 0.5% - 3%<sup>2</sup> combined with the expectation that the conflict in the East subsides.

### DEMAND

Warehouse market did not display any notable changes over the course of H1 2015 amid generally unfavorable economic conditions and high uncertainty among occupiers. Transactional activity in the industrial sector declined significantly over H1 2015: approximately 46,000 sq m (-14.8% y-o-y) in take-up was recorded on the market, with the prevailing share of transactions driven by relocation decisions. Occupier activity in the industrial sector was largely dominated by 3PLs&Transportation (45.9% of all transaction volume) and retail operators (33.4% of all transaction volume). At the same time, the share of 3PLs&Transportation declined significantly (-14.4 pp y-o-y) compared to the same period last year due to contraction of occupied space, accompanied by relocations to newly delivered owned properties. For instance, FM Logistics moved from Terminal Brovary to own premises completed in Q1 2015. Zammler 3PL operator downsized its occupied space by 13,000 sq m in BF Warehouse. Such market dynamics illustrate rising competition on the speculative market stirred up by the growing vacancy and weakening demand from major occupiers.

### KEY TRANSACTIONS IN H1 2015

| OCCUPIER     | INDUSTRY                   | PROPERTY                              | DIRECTION             | sq m  | DEAL TYPE |
|--------------|----------------------------|---------------------------------------|-----------------------|-------|-----------|
| Ekol         | 3PLs, Transportation       | Impeco                                | Warsaw (M-07, E-373)  | 9,000 | lease     |
| Ekol         | 3PLs, Transportation       | Andakta                               | Warsaw (M-07, E-373)  | 5,000 | lease     |
| DSV          | 3PLs, Transportation       | Kyivshchyna Terminal 1                | T-1027                | 5,000 | lease     |
| Arda         | Wholesale and retail trade | ADG                                   | Kharkiv (M-03, E-40)  | 3,500 | lease     |
| Nokian       | Other                      | Merks                                 | T-1012                | 3,000 | lease     |
| ND Logistics | 3PLs, Transportation       | UKR DC Logistic center I - 3J Holding | Odesa (M-05, E-95)    | 2,000 | lease     |
| Gloria Jeans | Wholesale and retail trade | Pharmplaneta                          | Zhytomyr (M-06, E-40) | 2,000 | lease     |
| Ditrade      | Wholesale and retail trade | San Factory                           | Kyiv city             | 1,300 | lease     |
| KFC          | Wholesale and retail trade | RLC                                   | P-04                  | 1,000 | lease     |

\* - total area of a complex  
Source: CBRE Ukraine

<sup>1</sup> - real GDP, excluding the temporarily occupied territory of the Autonomous Republic of Crimea and Sevastopol

<sup>2</sup> - according to the latest forecasts of IMF, EBRD, World Bank, Ministry of Economic Development and Trade, NBU

Demand contraction is widely illustrated by further decline in the transaction size. The share of small transactions below 5,000 sq m continued to grow and reached 80% (+6.4 pp y-o-y) of all transaction volume, while large transactions in excess of 10,000 sq m were virtually absent over the course of H1 2015. The most notable transactions were signed by Ekol logistic company that leased 5,000 sq m of fresh storage in Andakta and 9,000 sq m in the Impeco warehouse. However, the latter deal was a short-term lease, and the unit was already vacated as of the end of H1 2015. Additionally, DSV, a logistics company, relocated from FIM Service warehouse to Terminal Kyivschna by leasing 5,000 sq m.

**SUPPLY**

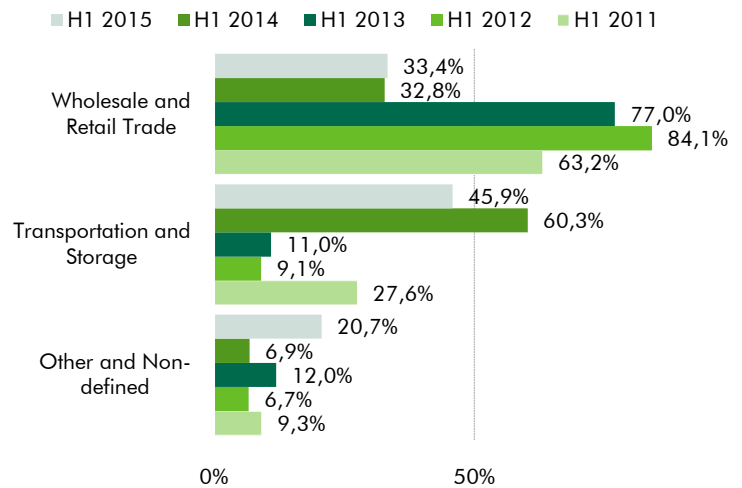
No new warehouse schemes were delivered speculatively in H1 2015. As a result, total speculative stock of warehouse space remained unchanged at approximately 1.29 mln sq m as of the end of Q2 2015. Development of warehouses for leasing purposes proved literally unviable at prevailing rental rates and virtually inaccessible debt financing. The trend is expected to continue with no projects to start on a purely speculative basis till the end of 2015. At the same time, demand for warehouse space was gradually shifting from leasing towards owner-occupation. However, this growing construction activity in the owner-occupied sector was largely driven by long term cost-reduction strategies of key players with strong budgets rather than shortage of available space. Notably, during the first six months of 2015 the volume of new completions for owner-occupation amounted to 22,000 sq m within phase III of FM Logistics (14,000 sq m) and Imperial Tobacco (8,000 sq m). Approximately 80,000 sq m of new industrial space in total is expected to be delivered for owner-occupation purposes within four schemes by the end of 2015.

**VACANCY**

Warehouse market was directly affected by decelerating business activity of major occupiers, including 3PLs&Transportation, retail and manufacturing companies. Due to the fact that ongoing letting activity was dominated by relocations, there was no improvement in the overall vacancy rate on the Kyiv warehouse market.

Notwithstanding the absence of new speculative completions, contraction of occupied space forced average market vacancy to grow by 2.2 pp compared to the end of 2014 and reached 17.1% as of June 2015.

**TAKE-UP STRUCTURE BY INDUSTRY\***



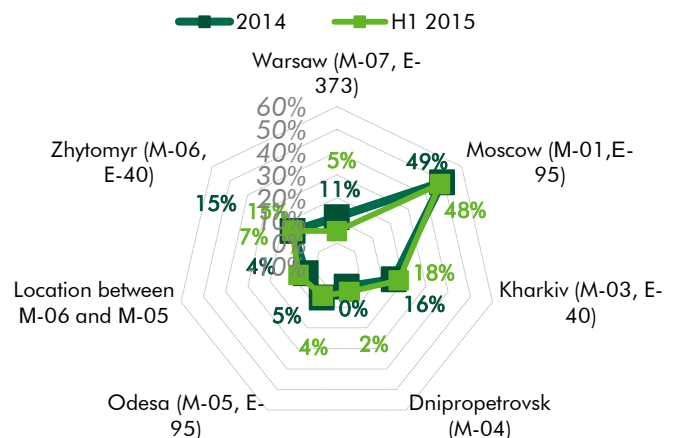
\* base - number of transactions  
Source: CBRE Ukraine

**KEY WAREHOUSE SCHEMES IN H1 2015\***

| NAME                     | DEVELOPER        | WAREHOUSE PREMISES, sq m | COMPLETION/ANNOUNCED COMPLETION |
|--------------------------|------------------|--------------------------|---------------------------------|
| FM Logistics (Phase III) | FM Logistics     | 14,000                   | H1 2015                         |
| Warehouse complex        | Imperial Tobacco | 8,000                    | H1 2015                         |
| Warehouse complex        | Epicentr         | 40,000                   | H2 2015                         |
| Biocon                   | Biocon           | 15,000                   | H2 2015                         |
| Warehouse complex        | Slavutich        | 15,000                   | H2 2015                         |
| Warehouse complex        | Agrosvit         | 10,300                   | H2 2015                         |

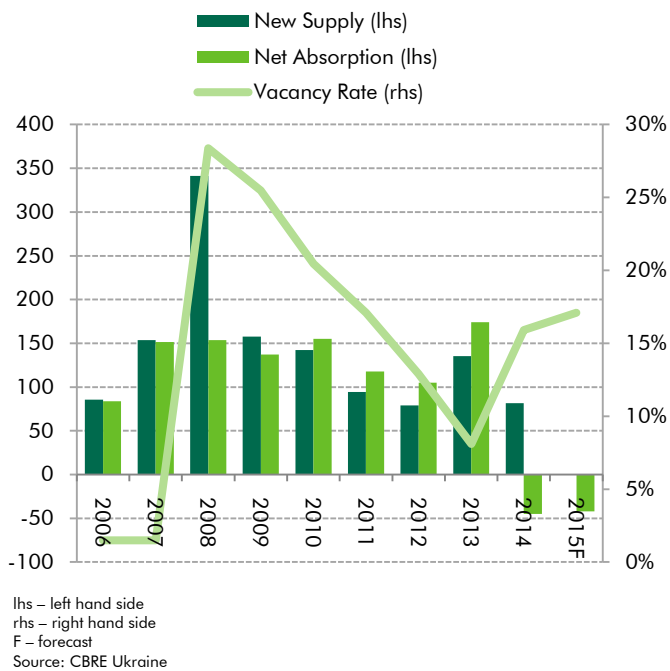
\* - for owner-occupation  
Source: CBRE Ukraine

**VACANT STOCK BY HIGHWAYS\***



\*base - total vacancy  
Source: CBRE Ukraine

NEW SUPPLY, NET ABSORPTION AND VACANCY RATE



Currency devaluation also affected main leased terms, as tenants struggled to keep up with currency devaluation. While previously rents were denominated in USD across the market, the practice of quoting rents in UAH became more widespread. Landlords continued to offer a broader range of incentives and rental discounts in order maintain occupancy particularly for existing tenants who might consider relocation options. The scope of incentives is very individual and depends on lot size, overall property vacancy, loan situation, location and quality.

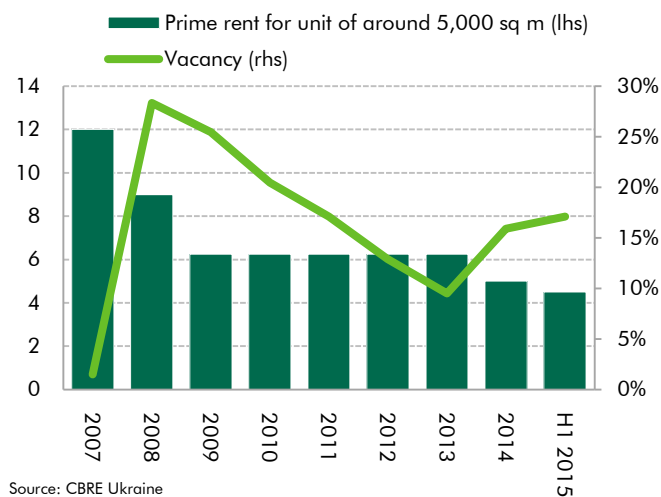
YIELDS

Faltering macroeconomic environment continued to provide negative investment sentiment. No investment transactions were recorded in the warehouse segment over the course of H1 2015. Ultimately, prime notional yield remained flat during H1 2015 standing at 16% for the best quality warehouses. Looking ahead, while the economy is poised for moderate growth in 2016, there is a potential for yield-searching investors to benefit from recovery on the market. However, downside risks to recovery are still substantial, and it will take time to translate investors’ interest into actual deals.

OUTLOOK

The warehouse market heavily suffered from deep decline in economic and occupier activity in H1 2015. Somewhat positive factor is, however, that we do not expect further deterioration of the situation during the rest of the year. Demand for warehouse space is forecast to stay roughly stable till the end of 2015, as major occupiers adjusted their space requirements to the prevailing economic circumstances. At the same time, take-up is expected to be driven mostly by relocation decisions with very few expansions and declining number of space contractions. Ultimately, throughout the next six months of 2015 take-up will have negligible impact on vacancy rates.

PRIME RENT AND VACANCY (USD/SQ M/MONTH)



High volumes of vacant space underlined negative net absorption displayed during 2014-H1 2015. To a large extent, negative absorption dynamics resulted from demand outflow from speculative market towards owner occupied space.

RENTS

Due to another drop in the value of the national currency, prime industrial rents denominated in USD declined by 10% from \$5.0/sq m/month to \$4.5/sq m/month for lot size of ca. 5,000 sq m over the course of the first six months of 2015. In addition, high vacancy and weakening demand exerted pressure on rental rates. Secondary competitive warehouse schemes experienced steeper decline of 15% - 20% over the same period.

Looking into 2016, stabilization of disposable income, projected curbing of inflation and rebound in retail turnover should be quick to translate into activation of storage and logistics requirements, which will translate into a moderate increase in demand for space, as 3PLs&Transportation companies will continue to make up lion’s share of warehouse tenants. We believe the development cycle has reached its cyclical low, with no additions planned on the speculative market till the end of 2015 at least.

By contrast, owner-occupied supply of warehouse premises is forecast to increase by 80,000 sq m in H2 2015 bringing the annual new supply to 102,000 sq m. However, an activation of new construction for own use will result in the demand outflow from the speculative market. While no new schemes are announced for delivery for speculative purposes, average vacancy rate is expected to stay broadly stable with small fluctuations of 2-4 pp possible by the end of 2015. Rents for prime schemes are expected to stabilize at the current level, with the expectation of no further negative economic factors in 2015.

## 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 transaction flow is very limited or made up of unusual one-off transactions. 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 transactions (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**

# RESEARCH REPORT

## Kyiv Industrial Big Box

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H1 2015

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