RESEARCH REPORT
Kyiv Office Market

CBRE | Ukraine
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HOT TOPICS

- Occupier demand strengthened moderately in 2015: estimated annual take-up amounted to approximately 60,000 sq m (+20% y-o-y)
- Development completions totaled 69,000 sq m (+6% y-o-y) by the end of the year, with the pace of delivery slowing down in H2 2015
- Average market vacancy posted a minor decline over 2015, yet remained at quite high level of 30.2% (-0.8 pp y-o-y)
- Rents were under downward pressure due to steep currency depreciation in Q1 2015, followed by stabilization over the rest of the year

DEMAND

Kyiv office market continued to face the consequences of protracted economic downturn that reached its lowest point during the first six months of 2015. Nonetheless, despite the fact that general economic malaise weighed heavily on business activity and employment indicators in H1, most companies stopped staff reductions and looked for opportunities to optimize their real estate costs in H2 2015 - either through renegotiation of lease terms or upgrading quality of occupied office space. In turn, the occupiers' demand showed tentative signs of strengthening backed by minor economic stabilization and rent adjustments recorded on the market during the last six months of 2015. Given beneficial lease terms and availability of quality office space, more relocations occurred across the market in the second half of the year, bringing the annual take-up to approximately 60,000 sq m, which is a 20% improvement compared to 2014, although still 40% below pre-crisis level of 2013. Relocations and renegotiation deals take the lead in terms of transaction type, representing around 90% of leasing activity, whereas expansions were very rare.

Following the previous year's trend, there was a distinct scarcity of large transactions in 2015, with the largest deal size ranging from 2,500 to 3,000 sq m. For instance, Embassy of Turkey leased around 2,900 sq m in the office building located in the Pechersk submarket, whilst Danone, FMCG company, rented 2,600 sq m in SP Hall Business Center in the CBD-fringe. The only exception was the relocation of Cogniance, IT&High Tech: 4,600 sq m of office space in Forum Victoria Park was taken-up by the company.

KEY OFFICE LEASE TRANSACTIONS IN 2015

OCCUPIER	INDUSTRY	PROPERTY	SUBMARKET	sq m
Cogniance	IT & High Tech, Telecommunications	Forum Victoria Park	NC-SW	4,600
Noosphere	IT & High Tech, Telecommunications	Baroque	Prime	3,100
Embassy of Turkey	Diplomatic Mission	Office building	Pechersk	2,900
Danone	FMCG	SP Hall	North	2,600
Infopulse	IT & High Tech, Telecommunications	Grand Step	South-West	2,500
Watsons	Wholesale and Retail Trade	SP Hall	North	2,400
Betlab	IT & High Tech, Telecommunications	Parkovyi	Pechersk	1,750
Nova Poshta	Transport and Logistics	Europa	NC-SW	1,520
DataRobot	IT & High Tech, Telecommunications	Farenheit	Olimpijskyi	1,500
Vega Telecom	IT & High Tech, Telecommunications	unknown	unknown	1,500
Philips	IT & High Tech, Telecommunications	Horizon Park I	South-West	1,200
PulsarFour	Service Industries	BC Advance	Podil	1,000
Kuehne + Nagel	Transport and Logistics	Office Building	NC-NW	1,000

Note: submarkets defined according to the new central business district (CBD) delineation introduced by CBRE in September 2011
Prime, Pechersk, Podil, Olimpijskyi, Shevchenkivskyi – CBD; South, South West, West, North – CBD fringe; NC-SW – non-central location, south west (right bank), NC-NW – non-central location, north west (right bank), NC-NE – non-central location, north east (left bank), NC-SE – non-central location, south east (left bank)
Source: CBRE Ukraine

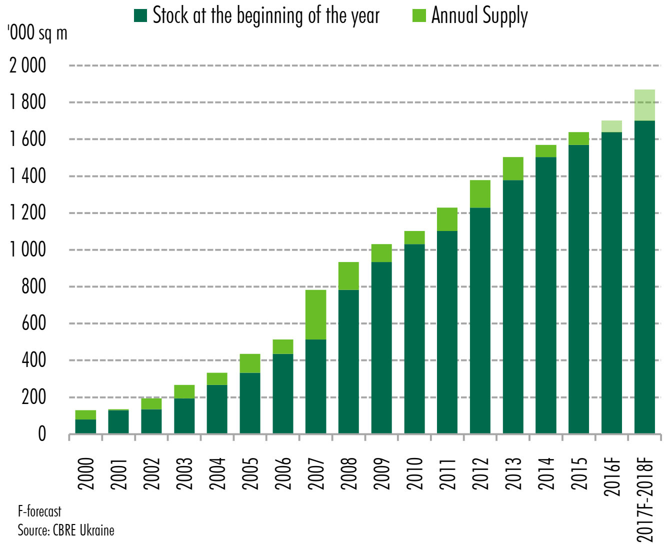
Take-up distribution by industry showed that IT, High Tech and Telecommunications sector demand rebounded in contrast to almost no activity the year before. In 2015 the share of IT, High Tech and Telecommunications in take-up of office space reached 38%, followed by FMCG and Healthcare&Pharmaceuticals, with 11% and 9% shares respectively.

SUPPLY

Despite the fact that the office market remained imbalanced, with vacancy hovering at approximately 30%, nine new office schemes were delivered during 2015. Annual new supply amounted to ca. 69,000 sq m (+6% y-o-y) by the end of the year, with more than 80% of that volume being delivered in H1 2015, with development pace significantly slowing down during the second half of the year. New office buildings were predominantly small and medium scale B class properties. Geographically, half of that volume was located within CBD in Olimpiyskyi and Podil submarkets. Thus total competitive office stock in Kyiv increased slightly to c.a. 1.64 mln sq m as of the end of 2015.

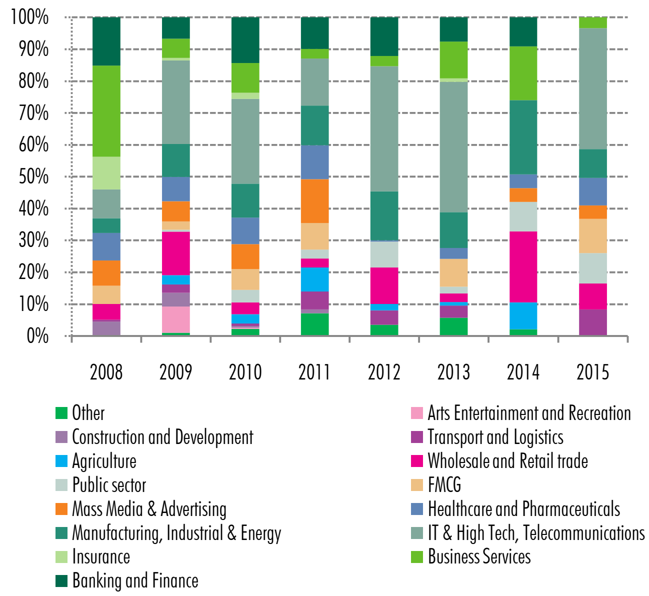
The trend of gradually increasing supply is expected to continue: approximately 62,000 sq m is forecast for delivery in 2016. Notably, the developers of well-performing operating business centers even under tough market fundamentals consider to expand their office properties. Hence the extensions to existing business centers represent 50% of forecast new completions, including Phase III of Lahoda Office Park (9,000 sq m GLA), Phase IV (15,000 sq m GLA) of Protasiv Business Park, as well as Phase III (8,000 sq m GLA) of Irva Business Center.

KYIV ANNUAL DEVELOPMENT COMPLETIONS AND TOTAL COMPETITIVE STOCK ('000 SQ M)*



F-forecast
Source: CBRE Ukraine

ANNUAL TAKE-UP BY INDUSTRY (% SHARE)



Source: CBRE Ukraine

NEW SUPPLY IN 2015 (MAJOR SCHEMES)

NAME	CLASS	ADDRESS	SUBMARKET	SUBMARKET	DEVELOPER	OFFICE GLA, SQ M	DELIVERY	STATUS
Office building	BA	6-10 Verhniy Val St.	CBD	Podil	Local	10,000	H1 2015	Stock
Office building	BA	32/36 Zhylyanska St.	CBD	Olimpiiskyi	Enerhobudlizynh	3,100	H1 2015	Stock
LB Bussines Center	BA	12 Laboratornyi Lane	CBD	Olimpiiskyi	Local	9,900	H1 2015	Stock
Bussines Center	BA	46-46A Horkoho St.	CBD	Olimpiiskyi	Local	7,500	H1 2015	Stock
Forum West Side (Phase I)	BB	6 Oleny Telihy St.	CBD-fringe	West	Forum Management Group	5,000	H1 2015	Stock
Office building	BB	3 Novovokzalna St.	CBD-fringe	South-West	Local	6,800	H1 2015	Stock
Office building	BC	Holosiivskyi Ave.	Non-central location	NC-SW	Local	15,000	H1 2015	Stock
Office building	BA	22 Panasa Myrnoho St.	CBD	Pechersk	Local	2,900	H1 2015	Stock
Red Star	BC	56 Chervonozoryanyi Ave.	Non-central location	NC-SW	Local	9,000	H2 2015	Stock

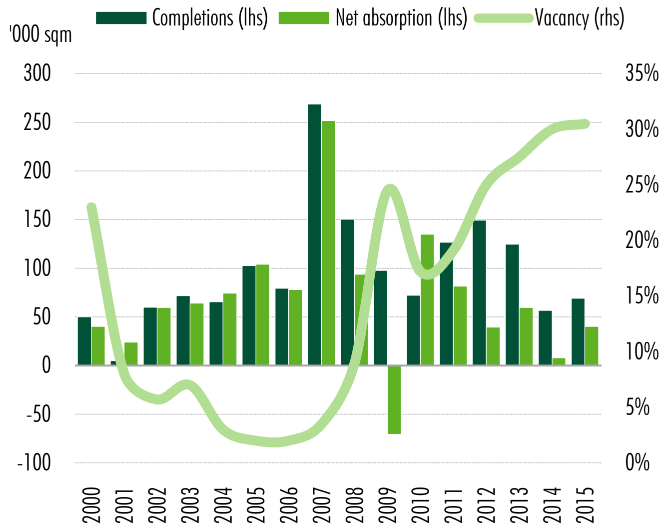
Source: CBRE Ukraine

FORECAST DEVELOPMENT COMPLETIONS 2016-2017*

NAME	CLASS	ADRESS	SUBMARKET	SUBMARKET	DEVELOPER	OFFICE GLA, SQ M	ANNOUNCED DELIVERY	STATUS
Lahoda (Phase III)	BB	21 Polyova St.	CBD-fringe	South-West	Kaskad Impex	9,000	2016	U/C
Protasov Business Park (Phase IV)	BB	2/1 Hrinchenko St.	CBD-fringe	South-West	DMV Group	15,000	2016	U/C
Irva (Phase III)	BC	10/14 Radischeva St.	Non-central location	NC-NW	Irva	8,000	2016	U/C
Office building	BA	1B Sahaidachnoho St.	CBD	Podil	Local	10,000	2016	U/C
Astra Residence	BA	58 Yaroslavska St.	CBD	Podil	Local	15,000	2016	U/C
K\MOST	BB	5A Zoolohichna St.	CBD-fringe	West	Local	5,500	2016	U/C
River Mall	BC	10-14 Dniprovska Naberezhna	Non-central location	NC-SE	Local	3,500	2017-2018	U/C
Sky Towers	AB	Peremohy Ave.	CBD-fringe	West	Cimbrorum Holdings	95,000	2017-2018	Halted
Retroville	BB	47 Pravdy Ave.	Non-central location	NC-NW	Stolitsa Group	10,800	2017-2018	Halted
Office Park	BC	1 Mahnitogorska St.	Non-central location	NC-NE	City Capital Group	60,000	2017-2018	Project

* according to developers' announcements
Source: CBRE Ukraine

NEW SUPPLY, NET ABSORPTION AND VACANCY RATE



lhs – left hand side
rhs – right hand side
Source: CBRE Ukraine

KYIV OFFICE ASKING BASE RENTAL RANGE, BY LOCATION AS OF Q4 2015 (USD/SQ M/MONTH)

Class A location	Quality A	Quality B	Vacancy Q4 2014	Vacancy Q4 2015
Prime	$23-28	$16-22	23.3%	19.2%
Pechersk	$20-30	$15-20	45.5%	46.3%
Podil	$18-25	$15-20	9.5%	16.7%
Shevchenkivskyi	-	$7-20	27.7%	20.4%
Olimpijskyi	$16-28	$8-20	22.9%	26.9%
Class B location	Quality A	Quality B	Vacancy	Vacancy
CBD fringe	$18-26	$6-20	25.8%	20.1%
Class C location	Quality A	Quality B	Vacancy	Vacancy
Non-central area	$13-18	$6-12	35.0%	42.9%

Source: CBRE Ukraine

VACANCY AND RENTS

Vacancy indicator showed mild contraction (-0.8 pp y-o-y) overall for the year, though diverging fluctuations were recorded during 2015. Initially the average market vacancy grew to 32.9% (+1.9 pp) during the first half of the year – due to increase in new deliveries in combination with restrained demand, but over the course of H2 the volume of vacant space declined slightly to 30.2% (-2.7 pp). The change was the result of declining pace of new completions coupled with minor strengthening of leasing activity.

Looking into by-the-submarket vacancy distribution, year-end indications suggest that tenants were very selective with their occupational choices. The office schemes which attract strongest level of interest from occupiers were typically those located in core central locations and CBD-fringe. In contrast to the dynamics recorded in 2014, there was a notable decrease in vacancy within Prime (-4.1 pp y-o-y) and Shevchenkivskyi (-7.3 pp y-o-y) submarkets in CBD, as well as -5.7 pp y-o-y decline in CBD fringe. This trend is partially associated with remarkable rental declines and landlord concessions across the board, which induced occupiers to improve office location through relocation. Another reason of contacting vacancy was the absence of new completions in the mentioned submarkets. At the same time, the significant increase in vacancy was recorded in Podil (+7.2 pp y-o-y) and Olimpijskyi (+4 pp y-o-y) submarkets owing to several new deliveries during 2015. However, occupiers displayed less interest in schemes located in more peripheral non-central locations, which factor, combined with increasing development completions, resulted in growing vacancy from 35% as of the end of 2014 to 42.9% by the end of 2015. As national currency sharply devalued in the beginning of the year, rents were under downward pressure, posting a sharp overall decline. The indicative effective prime rent declined by 8% on average from $25 to $23 per sq m/month (triple net) as of the end of Q1 2015.

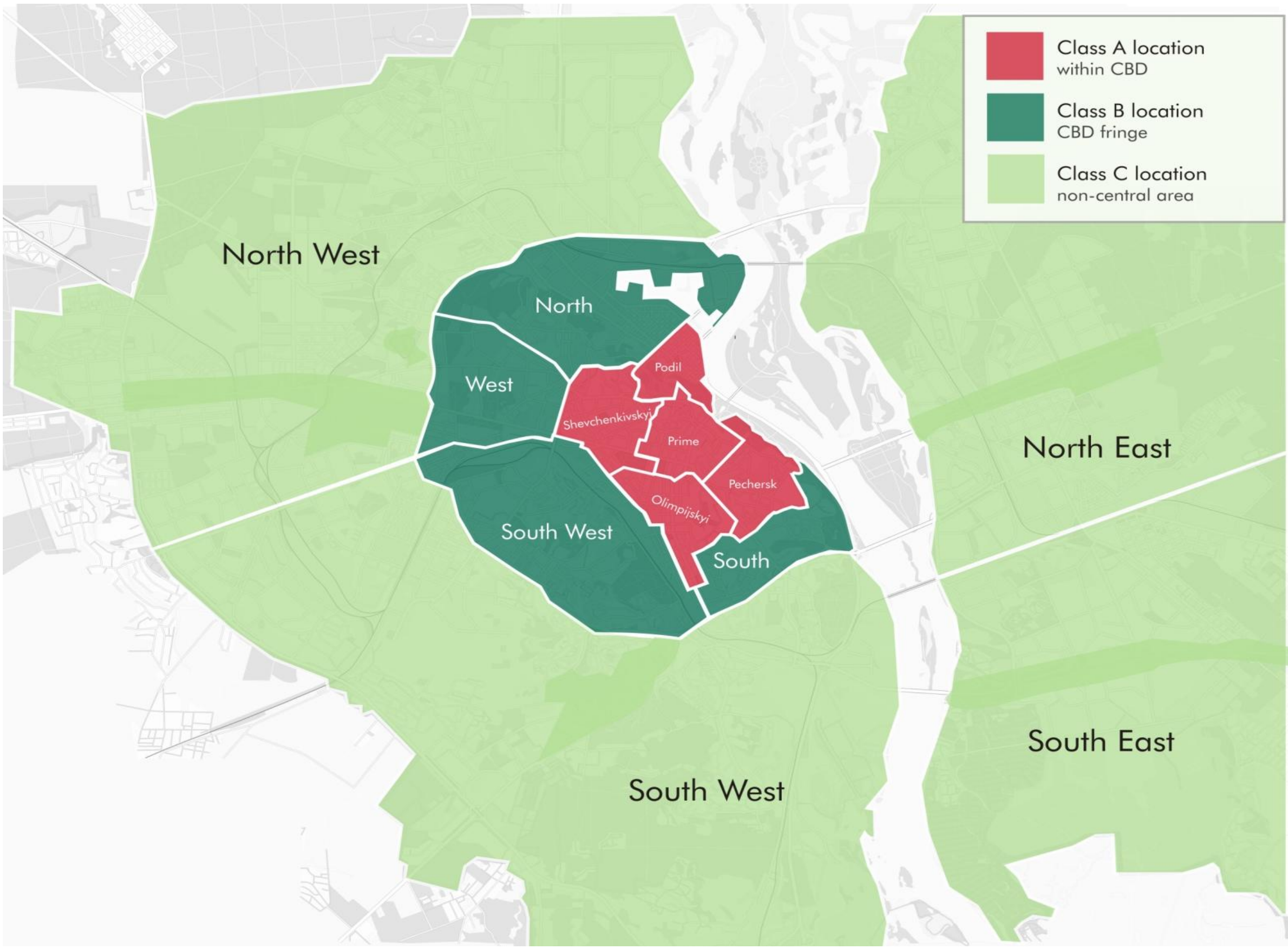
More severe declines were recorded in secondary schemes: rents displayed 20%-40% declines during the same period. On the positive note, prime rents remained stable over the rest of the year: indicative prime rent remained at $23 per sq m/month (triple net) at the end of December 2015. As before, the discrepancy between asking and effective rents remained wide, whilst landlords were ready to provide considerable incentives, including longer rent-free periods, fit-out contributions &c. A Grade effective rents ranged from $16 to $23 per sq m/month, whilst B Grade effective rents range from $7 to $18 per sq m/month as of the end of 2015.

OUTLOOK

Notwithstanding inevitably not easy year ahead, there are first signs of a somewhat more active office market, due to reduced economic volatility and calmer business sector forecasts for 2016. We expect moderate recovery in business activity of key occupiers, in particular in the second half of the year. As a consequence, more relocations are likely to follow, with expansions still expected to be rare. Approximately 62,000 sq m are forecast to enter the market by the end of 2016 in six office schemes, with half of that volume represented by extensions. However, delivery delays can be expected, as debt financing remains virtually unavailable, and overall the demand for office space will remain sluggish. Approximately 169,000 sq m of additional predictable supply may enter the market in 2017-2018. However, the likelihood of such planned volume reaching the market this period is rather low.

The market vacancy rate, which is now around 30%, will continue weigh on the market throughout the foreseeable future. In case of timely deliveries, average market vacancy will display further gradual growth in 2016. Nevertheless, best business centers are likely to experience declining vacancies owing to beneficial rents and willingness of corporate occupiers to upgrade quality of the premises. Prime rents will remain broadly stable across the board, in the absence of further economic and currency fluctuations, but separate cases of further slight declines in rents may be registered in the secondary schemes. Furthermore, we expect that many landlords of newly-delivered business centers will be compelled to offer considerable initial incentive combinations, in exchange for long term stepped rents.

KYIV OFFICE SUBMARKETS



Source: CBRE Ukraine

DEFINITIONS (in alphabetical order)

CBD – central business district

Leasing Activity – represents the total floor space 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. For offices, the **prime rent** should represent the typical "achievable" open market headline rent which a blue chip occupier would be expected to pay for:

- an office unit of standard size commensurate with demand in each location, typically 500 sq m
- an office unit of highest quality and specification within the local market
- an office unit within the prime location (CBD, for example) of a market

Take-up (gross absorption) – represents the total floor space 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 (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 gross leasable 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.

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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