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Ukraine
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RESEARCH REPORT

Kyiv Industrial Market, 2016

Stronger occupier demand, with take-up reaching 110,000 sq m

Total Competitive Stock
1.27 mln sq m
(0% y-o-y)

Lease Take-up
110,000 sq m
(+32.5% y-o-y)

Average Vacancy
12.0%
(- 3 pp y-o-y)

Prime Rents
4.1/sq m/month
(-9% y-o-y)

Hot Topics

- Absence of speculative development completions for the second straight year
- Stronger occupier demand, with take-up reaching 110,000 sq m (+32.5% y-o-y)
- Vacancy approaching equilibrium: average market vacancy contracted from 15.0% to 12.0% (-3 pp y-o-y)
- Minor decline in USD-based rents by year-end

DEMAND

Warehouse market mirrored an encouraging improvement in the economic fundamentals in the country evident over the course of 2016. Even though the pace of economic recovery was slow, key macroeconomic drivers of the demand for warehouse space, such as the volume of retail sales and industrial production, came into the positive territory after consistent declines during 2014-2015. Retail turnover increased by 6.3% y-o-y in Kyiv, stimulating the demand for warehouse space from large retailers such as food retail, electronics and e-commerce. Another marked trend was continued strengthening of industrial sector, with the volume of industrial production

Table 1: Key Lease Transactions in 2016

OCCUPIER	INDUSTRY	PROPERTY	DIRECTION	sq m	DEAL TYPE
Business Group	Wholesale and Retail Trade	Omega II	Chernihiv (M-01, E-95)	5,000	Expansion
Ekol	3PLs, Transportation	West Gate	Zhytomyr (M-06, E-40)	50,000	Renewal
Logistics Plus	3PLs, Transportation	West Gate	Zhytomyr (M-06, E-40)	3,000	Expansion
Auchan	Wholesale and Retail Trade	East Gate	Kharkiv (M-03, E-40)	35,000	Renewal&Expansion
Rozetka	Wholesale and Retail Trade	Terminal Brovary	Chernihiv (M-01, E-95)	21,000	Expansion
Baxter	Healthcare&Pharmaceutical	Trans West	Zhytomyr (M-06, E-40)	2,160	Relocation
Fitolek	Healthcare&Pharmaceutical	Galina Blanca	Chernihiv (M-01, E-95)	2,000	Relocation
Starkom	Wholesale and Retail Trade	West Gate	Zhytomyr (M-06, E-40)	4,500	Relocation
Nova Poshta	3PLs, Transportation	Omega	Chernihiv (M-01, E-95)	11,000	Relocation
Zammler	3PLs, Transportation	Tekhnopolis Brovary	Chernihiv (M-01, E-95)	17,000	Relocation&Expansion
Fiege	3PLs, Transportation	Terminal Brovary	Chernihiv (M-01, E-95)	7,600	Relocation
Oriflame	Wholesale and Retail Trade	Komodor	Zhytomyr (M-06, E-40)	8,900	Relocation
Foxtrot	Wholesale and retail trade	Mirazh Hostomel	Warsaw (M-07, E-373)	7,000	Relocation&Expansion

Source: CBRE Ukraine

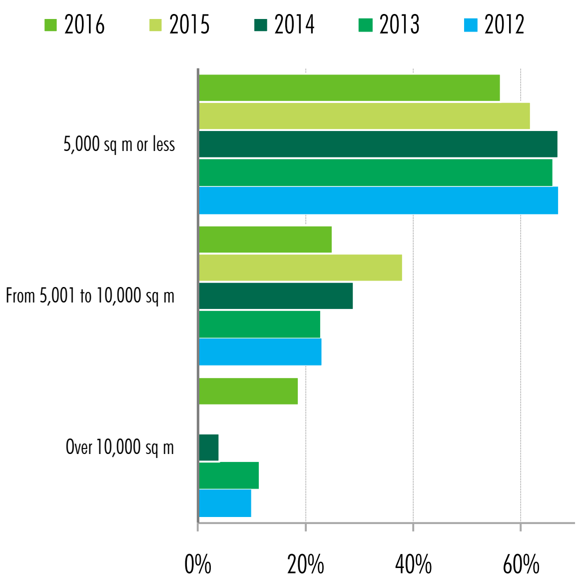
growing by 4.2% over the course of the year. These positive shifts in key sectors were translated into moderate recovery of occupier demand for the warehouse space. Hence, leasing activity (including renewals) reached approximately 195,000 sq m over the course of the year, with annual lease take-up totaling 110,000 sq m (+32.5% y-o-y) in 2016.

While small lease transactions (2,000 – 5,000) dominated the market as before, several medium (5,001 – 10,000) and large (over 10,000 sq m) transactions were recorded during the second half of 2016. One of the largest transactions in 2016 was the relocation of Zammler logistics operator, leasing ca. 17,000 sq m in Tekhnopolis Brovary. Another prominent transaction was the relocation and expansion of a large national postal and delivery operator Nova Poshta, leasing ca. 11,000 sq m in Omega II. Other remarkable transactions include Fiege logistics operator leasing ca. 7,600 sq m each in Terminal Brovary and Oriflame cosmetics retailer relocation, leasing ca. 8,900 sq m Komodor warehouses respectively.

Among most notable sales deals negotiated during 2016, Secure Property Development and Investment PLC signed agreement for the sale of Terminal Brovary warehouse to Rozetka, large Ukrainian e-commerce retailer. Before completing the disposal, the retailer also signed a lease agreement for ca. 21,000 sq m with SPDI. According to the agreement, the rent payments were deducted from the asset price once disposal occurred. The property was acquired mostly for owner occupation with expansion strategy in mind, with the property remaining partially leased to other tenants so far.

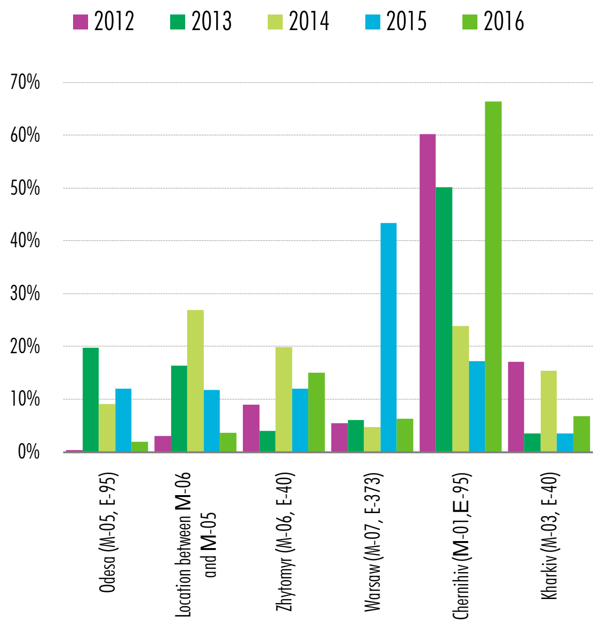
As for take-up distribution across highways, occupiers demonstrated an increasing interest in placing their warehouse facilities on the Left (East) bank: the share of take-up volume on the Left (East) bank reached approx. 75%. In particular, the largest volume of lease transactions materialized in the Chernihiv (M-01, E-95) direction, with the share of leased space increasing from 17.2% in 2015 to 66.4% in 2016.

Figure 1: Take-up Structure by Transaction Size*



* number of transactions
Source: CBRE Ukraine

Figure 2: Take-up Structure by Highways*



* base – volume of transactions, sq m
Source: CBRE Ukraine

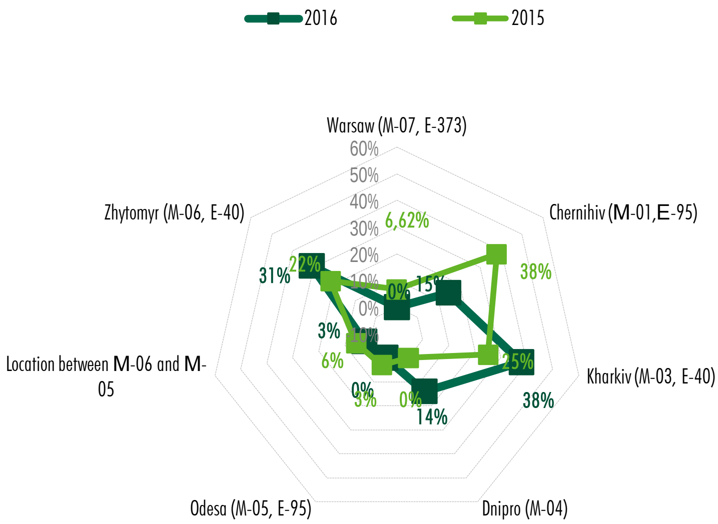
At the same time, the occupiers' activity on the Right (West) bank was mostly concentrated in the Zhytomyr (M-06, E-40) direction, reaching 15.0% (-3 pp y-o-y) of the total space leased in 2016.

Table 2: Key Future Warehouse Schemes in 2017-2018

NAME	DEVELOPER	WAREHOUSE PREMISES, SQ M	COMPLETION
SAN factory (Phase III)	Sky Development	4,100	2017
Warehouse complex	MERX	22,000	2017
Amtel (Phase II)	Amtel Properties	58,000	2017-2018

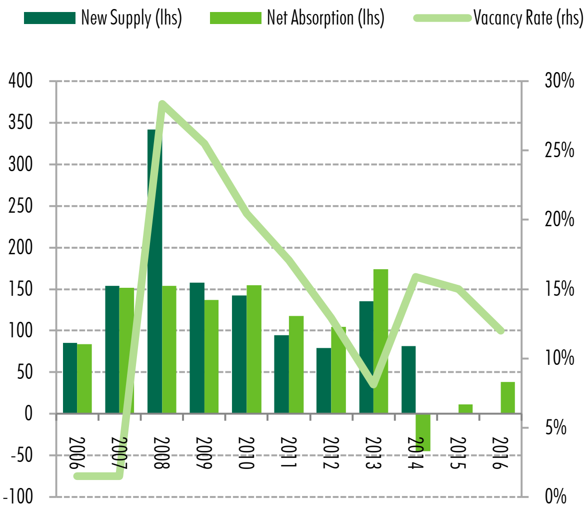
Source: CBRE Ukraine

Figure 3: Vacant Stock by Highways*



*base – total volume of vacant space
Source: CBRE Ukraine

Figure 4: New Supply, Net Absorption and Vacancy Rate



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

SUPPLY

On the supply side, no new warehouse schemes were delivered to the market over the course of the year. Thus far, the total competitive stock remained unchanged at ca. 1.27 mln sq m as of the end of 2016. Owing to low rents, still high vacancy and limited access to debt financing, the development of warehouse space intended for lease remained virtually absent. The pipelined volume of warehouse space amounted to meager 26,000 sq m as of December 2016. There are two warehouse complexes currently under construction: the third phase of the SAN factory warehouse totaling 4,100 sq m and MERX warehouse with storage space of 22,000 sq m scheduled for delivery in 2017. Low volume of warehouse space in pipeline and emerging deferred demand for warehouse space might gradually stimulate the developers to start construction under build-to-suit arrangements in anticipation of market recovery over the course of the next two-three years. Among likely future projects, the construction of Phase II of Amtel warehouse complex under build-to-suite arrangements is expected to commence in 2017, with delivery likely to take place in 2018.

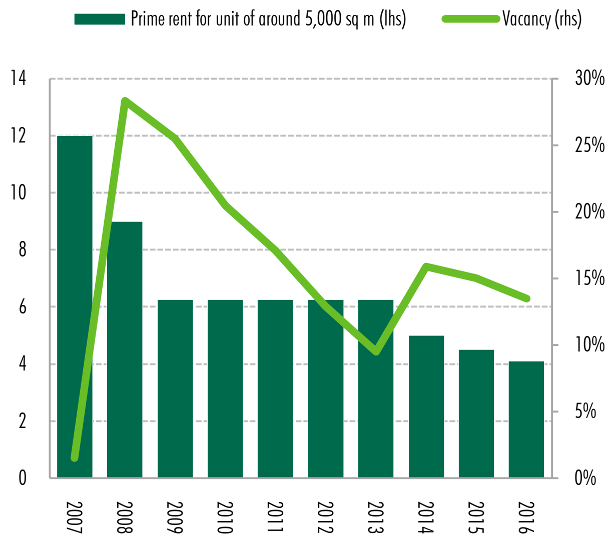
VACANCY

The absence of new speculative supply and generally stronger occupier demand brought the average market vacancy down by 3 pp from 15.0% to 12.0% by of the end of 2016. Looking at the distribution of unoccupied space across submarkets, the Chernihiv (M-01,E-95) Highway was the take-up champion by recording a 23pp contraction of vacancy down from 38% to 15% as of the end of 2016, after the vacancy rate in this submarket hit a peak in 2014-2015. The trend of declining vacancy also continued along the Warsaw (M-07, E-373) Highway and currently stands next to naught. At the same time, as the take-up was still predominantly driven by relocations, a growing volume of available space was recorded along Kharkiv (M-03, E-40) and Zhytomyr (M-06, E-40) Highways reaching 38% (+13 pp y-o-y) and 31% (+9pp y-o-y) respectively.

RENTS

As the crisis of 2014-2015 was marked by sharply declining occupier demand accompanied by wild USD/UAH exchange rate fluctuations, landlords started to quote rents for warehouse space mostly in UAH in order to retain their tenants and hold back rising vacancy. In 2016 the trend of UAH-denominated rents continued across the market, with rare cases of quoting rents in USD/EUR. As a result, while better market fundamentals supported the stability of UAH-based rental rates during the year, USD–denominated rents posted minor declines due to slight UAH devaluation during the last three months of 2016. Prime rents for top-quality properties declined by approximately 9% and stand at $4.1/sq m/month (net of VAT and OPEX) as of the end of December 2016. Looking across the warehouse classes, rents for A class warehouses varied in the $2.8 - $4.0 sq m/month range, while rents for B-class warehouses were in the $1.8-$2.8 sq m/month range as of the end of 2016.

Figure 5: Rental and Vacancy Rates (USD/sq m/month)



Source: CBRE Ukraine

INVESTMENT

Improving economic environment with moderate recovery of occupier demand and reduced uncertainties had a positive impact on investment sentiment. Investors were considering the best industrial assets, motivated by a significant decline in capital values over the last two years and prospects of medium term market recovery. In 2016 Dragon Capital Investments Limited completed the acquisition of East Gate Logistics (49,600 sq m) from Akron Investment Central Eastern Europe II B.V. and 60% of stake in West Gate Logistics (97,200 sq m) from GLD Holding GmbH. The details of the transaction are not disclosed.

Looking ahead, we expect investment activity to pick up gradually, benefitting from improving investor interest as a result of economic stabilization. This trend is particularly true for less risk-averse local investors with better understanding of market peculiarities, while international players are likely to maintain the wait-and-see approach in the near term future.

OUTLOOK

Heading into 2017, we expect more robust recovery of demand for warehouse space, with growing share of tenants looking to expand their storage space. Large retailers and logistics operators are expected to be more active during the next 12 months. However, the leasing activity will be largely dependent on the pace of recovery of major industries and the availability of space in top-quality locations. Forecast completions are expected to reach 26,100 sq m in Phase III of SAN Factory (4,100 sq m) and Merx warehouse (22,000 sq m). Thus, the volume of new space is anticipated to be absorbed relatively fast on the back of pent-up demand from key occupiers previously searching for large units. Therefore, average market vacancy is forecast to approach equilibrium in 2017. UAH-based rents are expected to stay roughly stable, whilst the USD-denominated rents remaining highly dependent on the USD/UAH fluctuations.

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 dependent on **total competitive stock** definition or **total stock definition** (see below).

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.

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 (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.

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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