CBRE
Ukraine
Part of the CBRE affiliate network

RESEARCH REPORT

Kyiv Industrial Market, H1 2017

Rising demand, limited new additions and contracting vacancy

Total Competitive Stock 1.25 mln sq m (-2.1% YTD)

Take-up 70,000 sq m (+46.0% y-o-y)

Average Vacancy 9.5 % (- 2.5 pp YTD)

Prime Rents 4.1/sq m/month (+0% YTD)

Hot Topics

- Scant volume of new supply (8,200 sq m) after no additions to speculative stock for two consecutive years
- Continued recovery in take-up: total take-up (including end-user sale transactions) estimated at 70,000 sq m (+46% y-o-y)
- Vacancy declines below equilibrium: average market vacancy went down from 12.0% to 9.5% (-2.5 pp YTD) owing to emerging expansion of retailers and logistics companies
- Stability in prime rent at $4.1 sq m/month

DEMAND

In H1 2017 the warehouse market recorded a visible improvement on the demand side backed by moderate economic recovery. Healthier economic environment resulted in increasing activity from key occupiers, particularly from large-scale retail and logistics operators, accounting for 57% and 31% respectively in the total take-up. Hence, total take-up (including sale transactions) is estimated at 70,000 sq m (+46% y-o-y) year-to-date. Such a remarkable surge in gross absorption was predominantly driven by one-off sale transaction: Ghelamco Group sold Kopylov Logistic Park (31,000 sq m) to the Ukrainian discounter retailer ATB. The asset was acquired for owner occupation.

On the leasing market, take-up amounted to ca. 40,000 sq m, which is a 16.7% y-o-y decline vs. the same period last year. On the one hand, lower volume of leasing take-up is stipulated by demand redistribution between speculative and owner-occupied sectors and accompanied by growing deficit of large units for rent and limited development in the sector. In particular, growing demand from retailers is mainly evident in properties managed by logistics operators. For instance, the most notable expansion of METRO C&C storage facilities of ca. 14,000 sq m was recorded in FM Logistic warehouse. On the other hand, lease transaction activity is expected to grow significantly during the next six month, in

Table 1: Key Lease Transactions in H1 2017

OCCUPIER	INDUSTRY	PROPERTY	DIRECTION	SQ M	DEAL TYPE I	DEAL TYPE II
DSV	3PLs, Transportation	San Factory III	Kyiv	4,100	lease	expansion
Argo	Wholesale and retail trade	MLP Chaika	Zhytomyr (M-06, E-40)	1,500	lease	relocation
Business Group	3PLs, Transportation	UKR DC	Odesa (M-05, E-95)	1,448	lease	relocation
Business Group	3PLs, Transportation	RLC	Chernihiv (M-01, E-95)	4,300	lease	relocation
Rhenus	3PLs, Transportation	West Gate Logistic	Zhytomyr (M-06, E-40)	4,500	lease	expansion
Malbi	Manufacturer	ICT	Vyshneve	6,000	lease	new lease
Nova Poshta Logistic	3PLs, Transportation	Omega-2	Chernihiv (M-01, E-95)	8,600	lease	expansion
ATB	Wholesale and retail trade	Kopylov Logistic park	Zhytomyr (M-06, E-40)	31,000	sale	sale
Viessman	Manufacturer	Amtel	Odesa (M-05, E-95)	1,300	lease	relocation

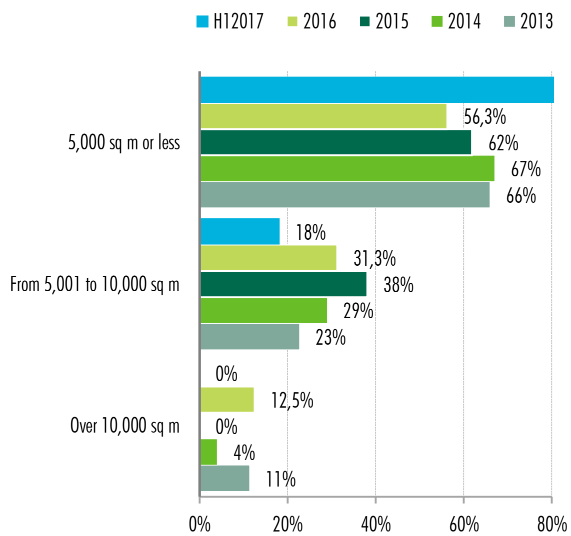
Source: CBRE Ukraine

case several current large-scale lease requirements materialize by the end of 2017.

Unlike the previous year when the take-up was mostly driven by relocations, several expansion transactions were negotiated during the first six months of 2017. Among the largest lease transactions closed in H1 2017 was the expansion of the national delivery operator Nova Poshta leasing additional 8,600 sq m in Omega II. Increasing storage requirements with more cases of expansion formed the prerequisite for growing absorption and declining vacancy.

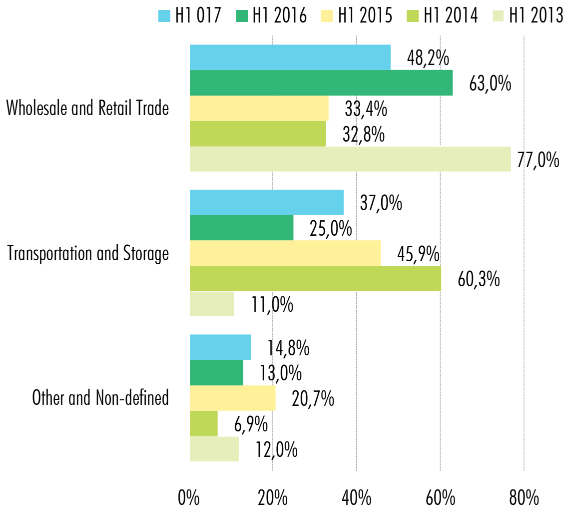
Looking into the leasing take-up structure by transaction size, the largest share of transactions was made up of small lots (below 5,000 sq m) comprising 82% of the volume, with the balance accounted for by the medium-size units. At the same time, large-scale requirements in excess of 10,000 sq m were satisfied either through acquisition of a vacant property or through expansion within the warehouse space provided by the logistics operator. Furthermore, we expect that occupier requirements for large units will be materialized in build-to suite arrangements in the nearest future.

Figure 1: Take-up Structure by Transaction Size*



* number of transactions
Source: CBRE Ukraine

Figure 2: Take-up Structure by Industry



* volume of transactions
Source: CBRE Ukraine

SUPPLY

Although no new warehouse schemes were delivered to the market during the previous two years, small-scale warehouse schemes entered the market in H12017. New supply included 4,100 sq m in Schastlyve 2 and 4,100 sq m in Phase III of SAN Factory. However, while new completions amounted to just 8,200 sq m, total speculative stock decreased by 2.1% YTD to ca. 1.25 mln sq m as of the end of June 2017, due to the mentioned acquisition of Kopylov Logistic Park (31,000 sq m) by ATB.

The volume of warehouse space currently planned for delivery in H2 amounted to just ca. 1,100 sq m in the extension of the SAN factory warehouse. The delivery of Phase III of Unilogic Park with the storage space of 22,000 sq m was postponed for the next year. As a result, speculative forecast completions are anticipated to amount to ca. 9,300 sq m y the end of the year. Despite the fact that occupier demand posted visible growth over H1 2017, development activity was still restrained due to low rents compared to development costs, as well as the absence of debt financing for development projects.

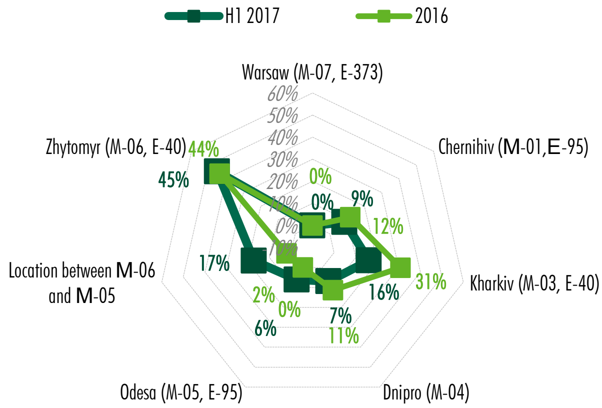
At the same time limited pipeline volume accompanied by expanding requirements for warehouse space from key occupiers, stimulated construction activity in the owner-occupied sector. In 2017 annual new supply for owner-occupation is forecasted at 34,000 sq m, which is more than half of the total new space coming to the market. While 7,000 sq m of Section 5 Phase III of FM Logistic was put into operation in H1 2017, additional 7,000 sq m extension in Section 6 Phase III is expected to be commissioned by the end of 2017. The new space will be used by FM Logistic 3PL operator. Another notable owner-occupied scheme is Terminal Nova Poshta providing 20,000 sq m of storage space for national delivery operator Nova Poshta.

VACANCY

Vacancy rate declined continuously during 2017, reaching 9.5% as of June 2017, which is 2.5 pp lower than at the end of 2016. The decline was made possible thanks to a rising demand from occupiers, limited new additions and contracting speculative stock on the back of sizable purchase transaction for own use. Furthermore, growing net absorption reflected the change in occupier sentiment from savings-driven relocations to expansions.

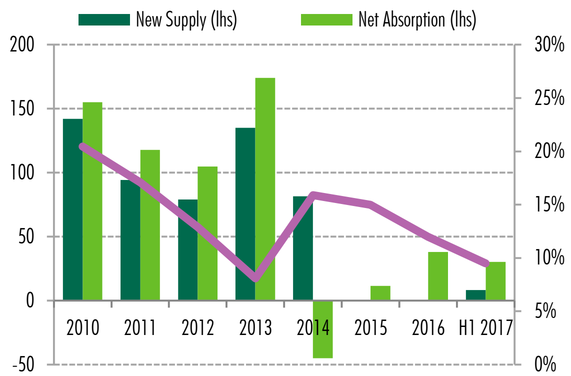
Looking at the distribution of unoccupied space across submarkets, the Kharkiv (M-03, E-40) Highway was the take-up champion by recording a 15pp contraction of vacancy from 31% down to 16% as of the end of H12017. After hitting its peak in 2015 the trend of declining vacancy also continued along the Chernihiv (M-01, E-95) Highway and currently stands around 9% (-3 pp) of total vacant space. Still, the largest share of available warehouse premises in the total structure of vacant space is located along the Zhytomyr (M-06, E-40) (45%), Kharkiv (M-03, E-40) Highways (16%) and the zone between M-06 and E-05 Highways (17%).

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

Table 2: Key Future Warehouse Schemes in 2017-2018

NAME	DEVELOPER	WAREHOUSE PREMISES, SQ M	STATUS	ANNOUNCED COMPLETION
SAN factory (Phase III)	Sky Development	4,100	Delivered	H12017
Schastlyve 2	Local developer	4,100	Delivered	H12017
FM Logistic Section 5 (Phase III)*	FM Logistic	7,000	Delivered	H12017
SAN factory (Phase IV)	Sky Development	1,100	Under Construction	H22017
FM Logistic Section 6 (Phase III)*	FM Logistic	7,000	Under Construction	H22017
Terminal Nova Poshta*	Nova Poshta	20,000	Under Construction	H22017
Unilogic Park III	MERX	22,000	Under Construction	2018
Amtel (Phase II)	Amtel Properties	52,000	Project	2018
Warehouse Complex	Local developer	3,500	Project	2018

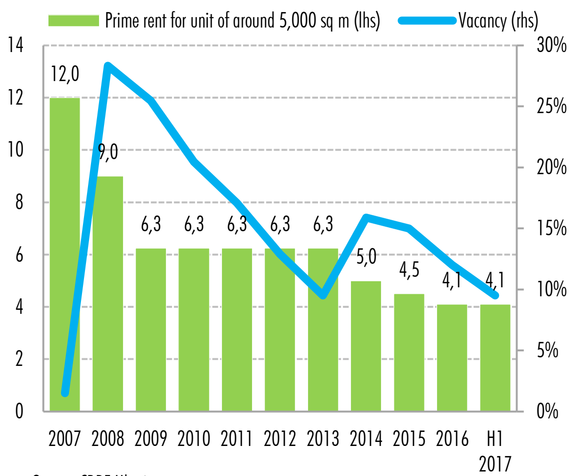
Source: CBRE Ukraine
* - for owner occupation

RENTS

In 2014-2015 most landlords started to quote rental rates in UAH forced by significant fluctuations of USD/UAH exchange rate. In 2016 the trend of UAH-denominated rents was adopted by the majority of market players. In H1 2017 national currency gained in value, thereby supporting the stability in USD/EUR-denominated rents for quality warehouse space. However, widespread excess supply had to be absorbed before demand would start driving rental growth.

Indicative prime rents for top-quality space in Kyiv Region maintained stability at $4.1/sq m/month (net of VAT and OPEX) as of the end of June 2017. However, while the prime rent remained stable, the lower bracket of rental range denominated in USD went up by 7% in A-class and by 23% in B-class properties driven by stronger hryvnya and rising occupier demand. Rents (net of VAT and OPEX) for A-class ranged between $3 and $4/sq m/month (UAH85 - UAH110 sq m/month) on average, while rents for B-class properties stood in the $2.3-$3 sq m/month range (UAH60 - UAH80/sq m /month). In addition to rental payments, tenants reimburse operating expenses (OPEX) at the exact amount per sq m stipulated in the agreements. Due to increasing energy costs, land taxes, and nominal wages, OPEX grew by roughly 10%-20% and varied between $0.5 and $0.6/sq m/month (UAH12-UAH15/sq m /month) net of VAT as of the end of H12017.

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



Source: CBRE Ukraine

INVESTMENT

While the market was still in its recovery phase, no pure investment transactions in the warehouse sector took place in H12017. With a relatively favorable and improving economic outlook, the future is holding the prospects of rising occupier demand for warehouses and moderate upward movement in rental values, particularly for the best space. Owing to a better economic backdrop, healthier occupier demand and improving investors' sentiment, prime yields firmed up by 0.5 pp during H1 2017. We expect the investment activity to improve further, subject to no economic swings in the meantime. Investors are expected to be mostly interested in core assets, whereas the demand for secondary, value-add opportunities is gradually picking up in anticipation of future capital gains.

OUTLOOK

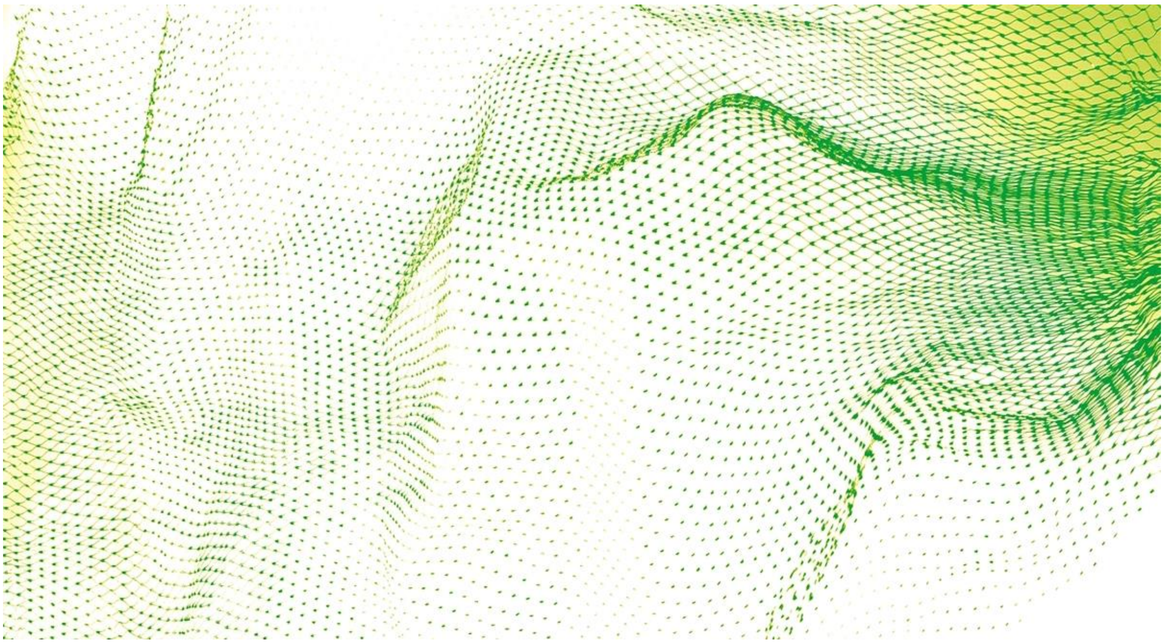
In general, 2017 promises to be an active year for the warehouse market on the demand side. We expect demand to continue showing upward trend for the rest of the year. While relocations were the main driver of take-up over the course of the previous two years, in 2017 the trend of growing share of expansions in total take-up is likely to be more evident in view of stronger business activity in key sectors. Notwithstanding the fact that several expansion requirements were satisfied during the first half of the year, there is an encouraging volume of currently outstanding demand for warehouse premises.

On the supply side, 1,100 sq m of warehouse space is expected to enter the market over the next six months in Phase IV of SAN factory. Unilogic Park III (22,000 sq m) is expected to postpone the delivery for 2018. As a result, we downgraded our annual forecast completions to ca. 9,300 sq m of warehouse space intended for lease, which is a very insignificant volume which will have no noticeable effect on the market. We expect this new supply to be quickly absorbed due to the existing pent-up demand from occupiers and the scarcity of new speculative completions.

The average market vacancy is forecast to contract further by the end of the year. Asking rents are likely to gradually increase on the back growing demand and limited news space.

At the same time, active construction activity for owner-occupation is reducing potential demand for speculative space, which, in turn, is holding back rental recovery and speculative construction. In 2017 the market will witness ca. 34,000 sq m of new space intended for owner-occupation.

Among likely future projects, the construction of Phase II of Amtel warehouse complex (52,000 sq m) under build-to-suite arrangements is expected to commence in 2017, with delivery likely to take place in 2018. Hence, the market is demonstrating the needed positive trends; however, movements in rent and capital values will be largely dependent on the demand distribution between speculative and owner-occupied schemes, general economic activity and financial stability in the country.



CONTACTS

For more information regarding this Research Report, please contact:

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

Radomyr Tsurkan
Managing Partner
e: radomyr.tsurkan@cbre.ua

Kira Pruglo
Head of Research
e: kira.pruglo@cbre.ua

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**