Kyiv Retail Market, H1 2017

Moderate rental growth fueled by stronger occupier demand

Retail Turnover +9.5% Y-O-Y

New Completions 8,000 sq m

Rents Up by 10%- 20% YTD

Average Vacancy 7% (-4 pp YTD)

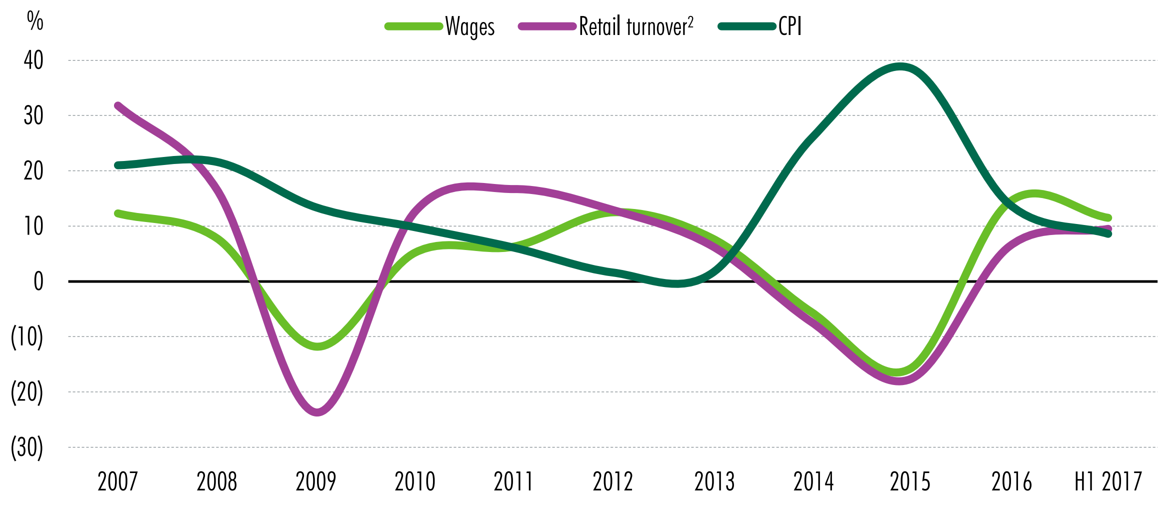
Hot Topics

- Recovery of occupier demand gaining pace, with organized retail turnover growth at +9.5% y-o-y
- Declining volume of new supply: 8,000 sq m of new retail space delivered in H1, with annual forecast completions expected to amount to 56,000 sq m
- Average market vacancy trending downwards to 7% (- 4 pp YTD) due to growing absorption
- Gradually appreciating rents by 10%-20%: rents for prime space varied in $60 - $86/sq m/month range, with rents in other schemes in the $30-$45/sq m/month range

FUNDAMENTALS

After a frail economic upturn recorded in 2016, Ukraine's economy continued to follow the recovery trend demonstrating moderate growth. The latest GDP figures revealed an economic growth of 2.5% (y-o-y) in Q1 2017. In line with the preliminary estimates announced by the Ministry of Economic Development and Trade of Ukraine, the 2.5% y-o-y GDP growth was sustained in Q2 2017. At the same time, the previously expected 3% y-o-y GDP growth forecast was downgraded by major Ukrainian and World economic institutions, expecting 1.8% - 2.0% y-o-y for the whole of 2017, largely as the result of transport blockade of the ATO zone. Despite the fact that the trade blockade is expected to negatively impact the economy in the near term, with further consumer demand and investment growth fueling overall economic growth. Consumer prices accelerated by 7.9% YTD (CPI) and remained broadly in line with the annual inflation target of 9.1% adopted by the National Bank of Ukraine for 2017.

Figure 1: Kyiv Wages, Retail Turnover and Consumer Price Index (% change, y-o-y)[1]



[1] Excluding the temporarily occupied territories, the Autonomous Republic of Crimea, the city of Sevastopol and part of the anti-terrorist operation zone.
[2] Includes organized retail sales only
Source: Kyiv Statistics Office

DEMAND

Moderate inflation, and relatively stable exchange rate alongside rising real wages (+11.5% y-o-y) helped spur private consumption and spending patterns during the first half of the year. Positive consumer sentiment was manifested in recovering consumer expectations: GfK Consumer Confidence Index grew by 5.7 points reaching 59.4 in H1 2017. The organized retail turnover grew by 7.1% y-o-y throughout the country, with growth much stronger in Kyiv at 9.5% y-o-y over January – June 2017. These significant positive shifts in consumer demand indicate more solid recovery in occupier demand for retail space in the future.

While tentative signs of occupier demand recovery were observed during the previous year, positive shift in retailer strategy from one-off openings to clearly defined expansion plans was evident in H1 2017. Food retailers (Fozzy Group, ATB, Auchan Group, EKO-market, Retail Group) and drogerie (EVA, Watsons) chains remained the most active in terms of the number of opened stores. Hypermarket segment witnessed redistribution of market shares between major players: French hypermarket retailer Auchan Group acquired nine Karavan hypermarkets, with three out of nine locations in Kyiv. The previous M&A deal closed by Auchan Group in 2013 was acquisition from German Metro Group of Real grocery chain in Eastern Europe, including two hypermarkets in Ukraine. Alongside the acquisition strategy, Auchan resumed natural expansion after a 3-year freeze, with one hypermarket scheduled for opening in Phase I of Rive Gauche SC by the year end.

The majority of fashion retailers declared that they intend to expand over the course of the year focusing on shopping centers as primary destinations for new stores. Spanish fashion giant Inditex is expected to open 6 new stores in recently delivered Lavina Mall SC and launch Stradivarius Man in Sky Mall SC after announcing the initiative globally in the beginning of the year. Polish retailer LPP Group announced the resumption of their activity in Ukraine after several years of halted expansion. ARGO fashion group, Sportmaster, and O'stin were among other retailers starting to grow their store chains during H112017. While the Turkish retailer LC Waikiki did not halt expansion during 2014-2016, the retailer announced that ten new stores will be opened by the end of the year. Moreover, several Ukrainian start-up brands such as Vovk, MustHave, Arber, Anabel Arto, etc also continued their expansion in the most sought-after retail destinations. Additionally, strengthening of occupier demand for retail space was reflected in cross-border activity. In H1 2017 we recorded the opening of twelve new brands, with mid-range fashion and special clothing retailers dominating the number of new entries.

Table 1: Kyiv Cross-Border Market Entry

MARKET NEW ENTRY		
Brand	Retail Sector	Entry location
Saucony	Specialist Clothing	Lavina Mall
COLE HAAN	Specialist Clothing	Ocean Plaza
Okaidi	Childrenswear	Lavina Mall
Xetra	Mid Range Fashion	Gulliver
BALDESSARINI	Luxury and Business	Ocean Plaza
Hanro	Specialist Clothing	Gulliver
Lee Cooper	Mid Range Fashion	Dream Town
Xiaomi	Consumer Electronics	Prospekt
Goldenpoint	Underwear	Lavina Mall
Fynch-Hatton	Mid Range Fashion	Lavina Mall
CCC	Specialist Clothing	Dream Town

POTENTIAL NEW ENTRY		
Brand	Retail Sector	Entry location
Decathlon	Specialist Clothing	SC
Defacto	Value and Denim	SC
Scotch&Soda	Luxury and Business	SC
Superdry	Mid Range Fashion	SC
Liu Jo	Luxury and Business	SC
Tutti Frutti Frozen Yogurt	Coffee and Restaurants	SC
Ni Hao	Coffee and Restaurants	SC
It's skin	Other	SC
Under Armour	Specialist Clothing	SC

Source: CBRE Ukraine

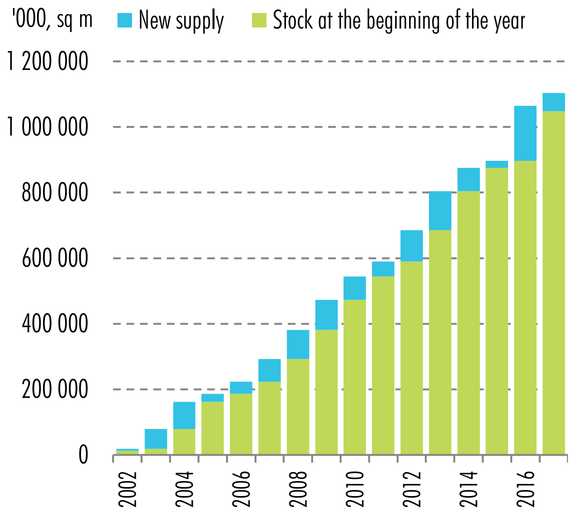
SUPPLY

While the retail market witnessed a strong surge of development completions of 168,000 sq m in 2016, the only small-scale shopping center Academ City (8,000 sq m GLA) was delivered in H1 2017. Hence, the total competitive stock of retail space in shopping centers in Kyiv increased to 1.06 mln sq m (+0.8% YTD). Additional 48,000 sq m of new supply is expected to be commissioned by year's end, including the small-scale Smart Plaza Polytech SC (15,000 sq m GLA) as part of a residential project, Phase I of Rive Gauche SC (20,500 sq m GLA) and Retail Park Petrivka (12,000 sq m GLA).

The last two projects are developed by Immochan Ukraine. In case actual openings of all the announced projects meet the planned schedule, annual completions are expected to reach ca. 56,000 sq m, which is three times lower as compared to last year's indicator. Nevertheless, decreasing volume of forecast new supply in 2017 is seen as a positive prerequisite for hastened absorption of the vacant space remaining available on the market.

Although the construction pace remained sluggish, a major surge in retail stock is expected in 2018-2019, with further delays in delivery remaining likely, pushing opening dates to 2020. Thus far, more than 528,000 sq m of new space are approaching the market in nine retail schemes currently at different stages of development. Active construction works are in progress on the city's Left (East) Bank in Rive Gauche SC (70,000 GLA of two phases) and River Mall (58,700 sq m GLA). Furthermore, after securing debt financing announced by Stolitsa Group, the construction of SC Retroville (80,700 sq m GLA) along with large-scale residential development is expected to accelerate during the rest of 2017, with delivery scheduled for H22018. Other projects remained inactive mostly due to financing issues.

Figure 2: Kyiv Shopping Center Stock



F – forecast
Source: CBRE Ukraine

Table 2: Key shopping centers in pipeline as of H1 2017

Name	Developer	GLA, sq m	Announced delivery
Rive Gauche (Phase I)	Immochan Ukraine	20,500	2017
Retail Park Petrivka	Immochan Ukraine	12,000	2017
Smart Plaza Polytech	UDP	15,000	2017
Smart Plaza Obolon	UDP	11,000	2018
River Mall	Vilna Ukraina	58,700	2018
Lukianivka	Arricano Real Estate	47,000	2018
Retroville	Stolitsa Group	80,700	2018
Rive Gauche (Phase II)	Immochan Ukraine	50,000	2019
Blockbuster Mall	Mandarin Plaza/Megaline	114,000	2019-2020
Ocean Mall	Mandarin Plaza/Megaline	70,000	2019-2020
Kyiv Mall	Dilais	58,000	2019-2020
Sky Mall (Phase III)	Prizma Beta	39,000	2019-2020
Respublika	K.A.N. Development	135,000	Halted

* The construction was halted on the final stage of development in 2015. Corporate rights for shopping center were transferred from the Nadra bank to the National Bank of Ukraine as collateral for loan refinancing (previously the corporate rights were transferred from the Megapoliszhylstroi (the company is affiliated legal entityto the K.A.N. Development) to Nadra bank as the part of repayment of non-performing loan).
Source: CBRE Ukraine

VACANCY AND RENTS

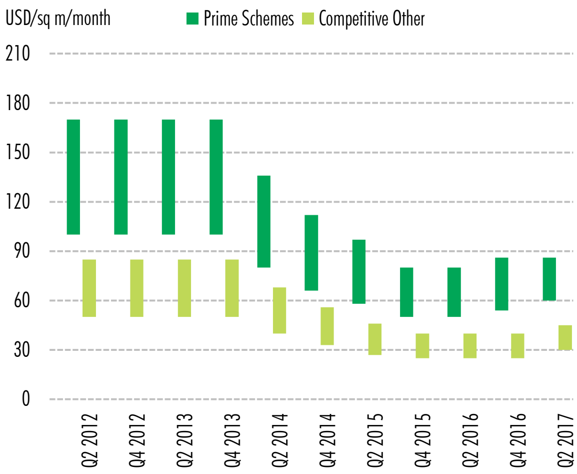
As the majority of retailers started to increase their presence on the market in H1 2017, the vacancy rate in Kyiv shopping centers was continuously trending downwards, due to gradual absorption of retail space delivered in 2016. At the same time, low volume of new supply was, however, almost fully absorbed with no significant effect on vacancy. Prime occupancy returned to the pre-crisis level of 0% - 2% driven by strong demand for prime space among existing and new retailers. Average vacancy in professional shopping centers declined by 4 pp standing at 7% in June 2017, due to accelerated absorption of new supply delivered at the end of 2016.

As recovery in rental income became visible in 2016, rental growth was evident in the majority of Kyiv's shopping centers over the course of H1 2017. Rents for prime space varied in the $60 - $86/sq m/month range, with lower bound of the range growing by ca. 12% year-to-date, and the achievable headline rent remaining relatively stable. As secondary schemes were much more vulnerable to negative effects of demand contraction in 2014-2015, rents in such schemes posted higher growth rates of 10% – 20% over H1 2017, standing in the $30-$45/sq m/month range as of the end of June.

INVESTMENT

While the tale of 2016 was one of stabilization, retail market demonstrated more sustainable recovery during H1 2017. Improving retail fundamentals amid declining uncertainty resulted in compression of prime notional yields over H12017. However, no notable investment transactions were recorded during the period, whilst some openly marketed retail assets were put up for sale primarily by the banks. In the long run, however, the retail market is likely to be affected by the large volume of pipeline scheduled for delivery during the next three to five years. Hence, growing rental incomes make retail assets a real estate product 'to watch', with investor interest focused on prime assets and secondary schemes with low existing and future competition.

Figure 4: Base Rents in Kyiv (USD/sq m/month)



Source: CBRE Ukraine

REGIONS

Regional retail sales continued to reflect the overall growth trend in H12017. Remarkable organized turnover growth was recorded in Zakarpattia (+22.1% y-o-y), Vinnytsia (+16.7% y-o-y), Sumy (+11.5% y-o-y) and Odesa (+12.0% y-o-y) Regions in H1. Large retail chains in the food segment (ATB, Fozzy Group, Tavria V) traditionally confirmed their leading positions in the regional cities. Auchan Group, however, gained its market share in regions after completing the acquisition of Karavan hypermarkets in June. Alongside assets located in the capital, Auchan Group strengthened its presence in four new cities - Kharkiv, Dnipro, Zhytomyr, and Chernivtsi. The nationwide discounter ATB continued to open stores gradually in the western regions and started activity in the south part of a country. Fozzy Group developed its new chain of discounters Thrash on the regional market, with the intention to attract $75 mln for this purpose. Additionally, SPAR supermarket, managed by Volwest Group, once again returned to the Ukrainian market. The chain plans to open 15 stores in the Western and Central regions by the end of the year. Increasing activity was observed among electronics and DIY operators as well. CITRUS, Comfy, and Allo started to open larger stores, while Eldorado and Foxtrot underwent store makeover. Epicenter K continued expansion in smaller cities and is scheduled to open a new hypermarket in Dubno, Rivne Region. Notwithstanding the recovering occupiers' interest outside the capital, construction of professional shopping centers on regional markets remained sluggish. No large-scale regional shopping centers are expected to be commissioned in 2017. New supply will be limited to small-scale Korona SC (7,800 sq m GLA) in Uzhhorod and Kadorr City Mall (15,000 sq m GLA) in Odesa. In 2018 we expect the delivery of Nikolskiy SEC (52,000 sq m GLA) by Budhouse Group in Kharkiv and Phase I of Les Vignes SEC (17,000 sq m GLA) by Immochan in Odesa. Delays in delivery of announced projects are, however, possible. Budhouse Group announced its plans to start the construction of Fabrika 2 SEC (68,000 sq m GLA) in Zaporizhzhia in 2018, with the delivery of the first phase planned for 2019. Even though regional markets are still experiencing the need for quality retail stock, a substantial 2:1 income gap between Kyiv and the regions explains the sluggish pace of regional retail development. In addition to the regional income disparity, Kharkiv and Dnipro continue to suffer from an additional risk factor as cities with higher exposure to the military conflict in the east of the country.

Through increased activity from retailers, the best shopping centers in regional cities experienced slight rental growth of up to 12% (YTD).

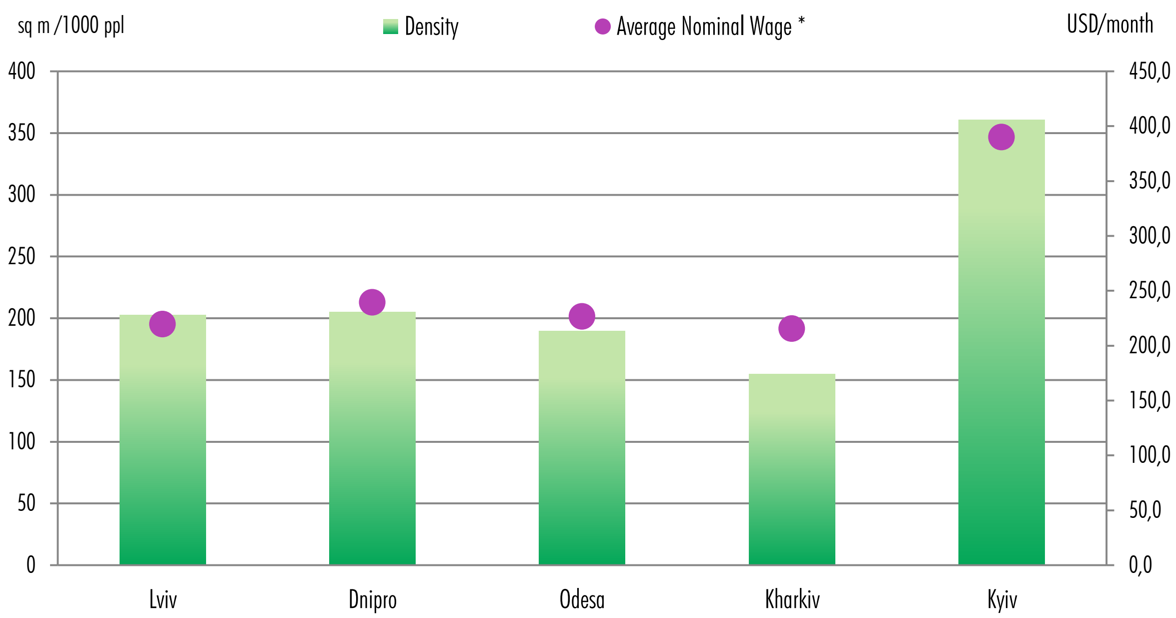
We expect regional rents to display further upward movement in H2 2017 mainly in schemes with good locations and professional concept. The vacancy is expected to approach zero level due to the limited availability of quality premises and growing demand from retailers.

OUTLOOK

We expect healthier consumer demand will be supported by the improving macroeconomic indicators during the rest of 2017. Retailers, in turn, will adapt to more robust consumer spending, growing turnover and footfall, with many of them starting to expand moderately over the next six month. Gradually increasing demand from existing retailers will be augmented by new demand from potential new entries in 2017-2018, including Decathlon, Defacto, Under Armour, Scotch&Soda, Superdry etc. Furthermore, H&M and IKEA included Ukraine into the business expansion strategy for the near future in case the market fundamentals continue to recover.

Annual new completions are forecast to amount to 56,000 sq m in 2017, which is 1/3 of the previous year's indicator. Despite new additions to the shopping center stock, the volume of new supply will not be greater than potential demand this year.

Figure 5: Density and purchasing power



Source: CBRE Ukraine, Kyiv Statistics Office, Lviv Statistics Office, Dnipro Statistics Office, Kharkiv Statistics Office
* The last available official data in regions (Q1 2017)

New schemes planned for H22017 are generally small in scale; hence, we expect new space to enter the market almost fully occupied due to already signed pre-leases from anchor retailers. Absorption of the existing vacant space predominantly concentrated in Lavina Mall SC will continue into the rest of the year. As a result, the average market vacancy will decrease further pushing rental rates upwards. Slowdown in new supply volume alongside revival of demand is expected to support retail rents in 2017. Moderate rental growth is expected in prime and secondary shopping centers over the course of H22017, as landlords are anxious to return to pre-crisis rental conditions. Looking beyond 2017, the inflow of new supply will have more widespread implications for the retail market landscape. While the volume of pipelined schemes remains huge, with the additional 530,000 sq m announced for opening within the next three years (not taking into account the frozen Respublika SC construction), total stock is due to surge by roughly 55% during 2017-2020. Notwithstanding this huge volume of new retail space, competition will remain a less pressing issue for the projects developed on Kyiv's Left (East) Bank due to lower market saturation and large-scale catchment area. At the same time, the majority of shopping centers (existing and new ones) will feel a significant increase in competition, as well as disrupting effects from the ever growing online retail.

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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.