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RESEARCH REPORT

Kyiv Office Market, 2017

Vacancy Hits New Low Implying Rental Growth Imminent

Take-up 155,000 sq m (+94.8% y-o-y)	**New Completions** 31,500 sq m (-28% y-o-y)	**Average Vacancy** 17% y-o-y (-10.5 pp YTD)	**Prime Effective Rent** $23/sq m/month (0% YTD)

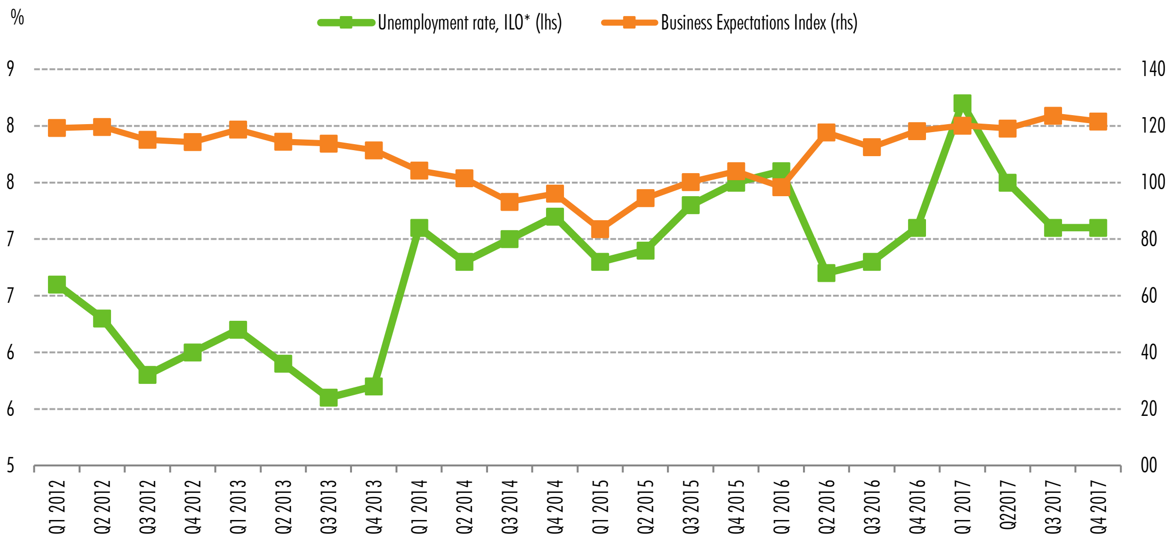
Hot Topics

- Annual take-up posted steep increase to approx. 155,000 sq m (+94.8% y-o-y), with expansion trend emerging
- New completions hit the new record low of 31,500 sq m (-28% y-o-y), due to delivery delays and no large-scale starts for over 3 years
- Average market vacancy displayed abrupt drop, reaching 17% (-10.5 pp YTD) by year-end
- Prime effective rents remained roughly stable at $23/sq m/month, while asking rents grew by 10%-20% YTD

DEMAND

2017 was an eventful year for Kyiv office market, strengthened by a combination of general political and economic stability. Although the economy grew slower than expected, the unemployment rate in Kyiv posted a declining trend and stood at 7.1% as of the end of Q32017, much lower than the country average indicator of 9.4%. Unemployed-to-Job Openings Ratio decreased from 2.1 to 1.4 over the course of the year, demonstrating the trend of growing employment requirements. Business sentiment shifted from anticipation of faint recovery to growth of cautious optimism. Kyiv Business Expectations for 12 months ahead displayed a mild increase of 3.4 points over the course of the year and reached 121.6, which is the highest indicator over the last five years.

Figure 1: Kyiv Business Expectations Over the Next 12 Months and Unemployment Rate



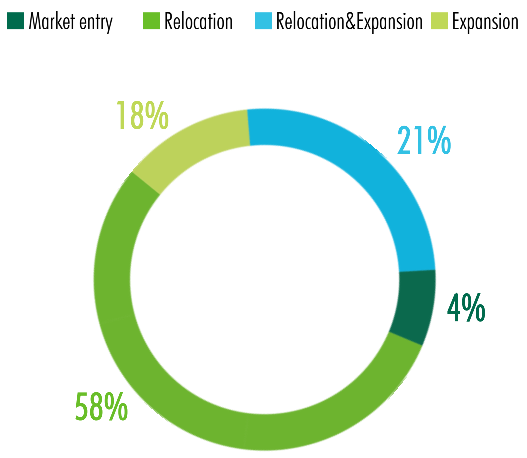
*latest available data as of the end of Q32017
Source: National Bank of Ukraine, Kyiv State Statistics Committee

lhs – left hand side
rhs – right hand side

In 2017 we recorded a consistent increase in the demand for office space, with estimated annual take-up reaching approx. 155,000 sq m (+94.8% y-o-y), which is almost a twofold upswing compared to the prior year's figure. Acquisitions by end-users comprised ca. 11% of total annual take-up. In contrast to 2016, when approximately 50% of leasing activity accounted for renewals and renegotiations, the indicator was just 23% in 2017, reflecting the general trend of occupiers willing to commit to new locations rather than stay and/or renegotiate.

Looking into lease take-up by motivation, the trend of growing space requirements became evident, highlighting a healthier market environment. Nearly 18% of total demand for lettings came from occupiers' incentive to grow their business and space occupied. Another 21% of leased space comprised relocations accompanied by expansions in the newly-leased properties. For instance, Ring, an IT & Hightech company, recently acquired by Amazon, relocated from Senator BC to Toronto Kyiv leasing ca. 1,000 sq m, thereby expanding its R&D center in Kyiv by an additional 1,100 sq m due to almost twofold employment growth. Grammarly, an actively growing IT product company, relocated to BC Gulliver with planned expansion to 3,200 sq m. Innovecs, software outsourcing company, expanded by ca. 2,000 sq m in Premium BC. Notably, the starting expansion of business service occupiers, including consulting, legal, and audit firms marked the tangible revival of business activity in the city. KPMG, a Big 4 audit consulting company, expanded its Kyiv headquarters by 1,500 sq m in A-class Senator BC, while McKinsey & Co, Big 3 Strategy consulting firm, relocated from Parus to Leonardo BC leasing ca. 600 sq m, growing its occupied space almost threefold. Another valuable trend was the emergence of new business coming to the market, accounting for ca. 4% of lease take-up in 2017. Largest market entries included SBTech leasing 1,800 sq m in Astarta BC, Frag Lab 1,800 sq m in Forum West Side, and Creative Quarter opening its 1st location in Gulliver in 2017. However, the trend is still in its infancy and should become more evident in 2018.

Figure 2: Total Take-up Structure by motivation (% share)



Source: CBRE Ukraine

Growing space requirements along with relocations of large-scale tenants resulted in increasing number of deals over 3,000 sq m, which were quite rare during 2016. Among top largest leases are Lifecell relocation to a ca. 5,000 sq m office in Eleven BC, Room 8 Studio leasing 4,500 sq m in Kosmopolit BC, Netcracker, Astarta, and Creative Quarter leasing ca. 4,000 sq m each in Astarta BC. However, existing requirements for more than 5,000 sq m will be hard to accommodate due to a significant decline in vacant space on the market.

As in previous years, IT, High Tech & Telecommunications tenants made up the lion's share of lettings, displaying slow albeit stable increase. Their share in the total take-up grew by 3.4pp to 43%. Business services occupiers were the second largest industry group leasing ca. 16% of total take-up, 5pp up from 11% in 2016. The growing footprint of business services was mostly driven by expanding co-working and serviced office sector along with the mentioned expansion of consulting services. Platforma Coworking opened its second location in Prime CBD area leasing ca. 2,300 sq m in Leonardo BC. Creative Quarter launched its first location (1,200 sq m GLA) in Gulliver BC and leased an additional unit in Astarta BC that is more than three times the size of its primary location.

Table 1: 25 Largest Office Lease Transactions in 2017

OCCUPIER	INDUSTRY	PROPERTY	ADDRESS	TRANSACTION TYPE	GLA SQ M
Lifecell	IT, High Tech & Telecommunications	Eleven	11 Solomianska St.	Relocation	5,000
Room 8 Studio	IT, High Tech & Telecommunications	Kosmopolit	6 Vadyma Hetmana St.	Relocation&Expansion	4,500
Netcracker	IT, High Tech & Telecommunications	Astarta	58 Yaroslavska St.	Relocation	4,100
Astarta	Agriculture	Astarta	58 Yaroslavska St.	Relocation	4,000
Creative Quarter	Business Services	Astarta	58 Yaroslavska St.	Expansion	4,000
Grammarly	IT, High Tech & Telecommunications	Gulliver	1A Sportyvna Sq.	Relocation&Expansion	3,200
PDF filler	IT, High Tech & Telecommunications	Parus	2 Mechnykova St.	Relocation	3,000
Intergalbud	Construction and Development	Office building	Nemyrovycha-Danchenko St.	Relocation	2,600
Ukrbud	Construction and Development	Eurasia	75 Zhylianska St.	Relocation	2,600
PUMB	Banking and Finance	Office building	5 Spaska St.	Relocation	2,500
Coworking Platforma	Business Services	Leonardo	19-21 Bohdana Khmelnytskoho St.	Expansion	2,300
Ring	IT, High Tech & Telecommunications	Toronto Kyiv	100 Velyka Vasylkivska	Relocation&Expansion	2,100
Bosch	IT, High Tech & Telecommunications	Silver Breeze	1V Pavla Tychyhy St.	Relocation	2,000
Sigma Software	IT, High Tech & Telecommunications	Astarta Phase I	58 Yaroslavska St.	Relocation	2,000
Innovecs	IT, High Tech & Telecommunications	Premium Center Business City	6z I. Lepse blvd.	Expansion	2,000
Siemens Ukraine	IT, High Tech & Telecommunications	Astarta Phase I	58 Yaroslavska St.	Relocation	1,800
ControlPay	IT, High Tech & Telecommunications	Forum Vicroria Park	7 Akhtyrskiy Ln.	Relocation	1,900
Nextiva	IT, High Tech & Telecommunications	101 Tower	57 L.Tovstoho St.	Relocation	2,000
Frag Lab	IT, High Tech & Telecommunications	Forum West Side	6 Oleny Telihy St.	Market Entry	1,800
ABBOT	Healthcare and Pharmaceuticals	Senator	2/32-34 Moskovska St.	Relocation	1,600
KPMG	Business Services	Senator	2/32-34 Moskovska St.	Expansion	1,500
Regus	Business Services	Forum West Side	6 Oleny Telihy St.	Expansion	1,400
GIZ	Public Sector	Panorama	20 Velyka Zhytomyrska St.	Expansion	1,300
Datarobot	IT, High Tech & Telecommunications	Senator 2	101 Volodymyrska St.	Relocation	1,200
Caparol Ukraine	Manufacturing, Industrial and Energy	Forum West Side	6 Oleny Telihy St.	Relocation	1,200

Source: CBRE Ukraine

Figure 3: Total Take-up Structure by Location (% share)

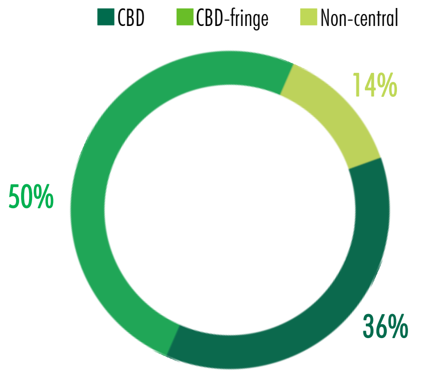


Figure 4: Total Take-up Structure by Industry (% share)

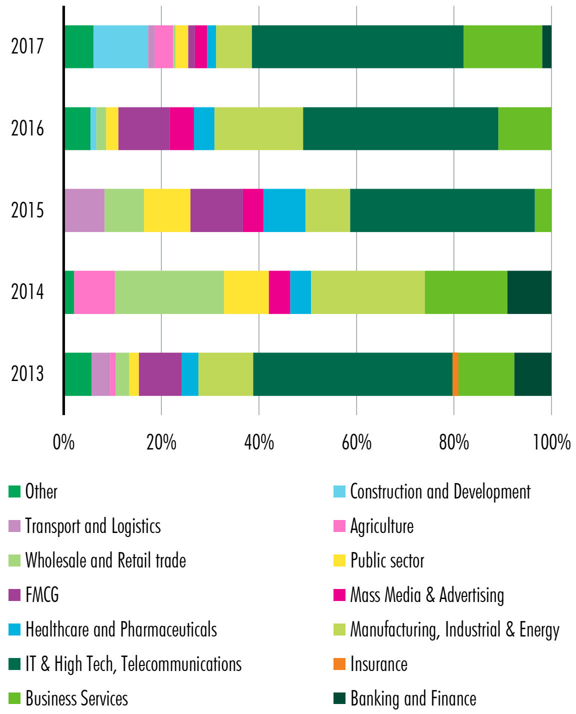
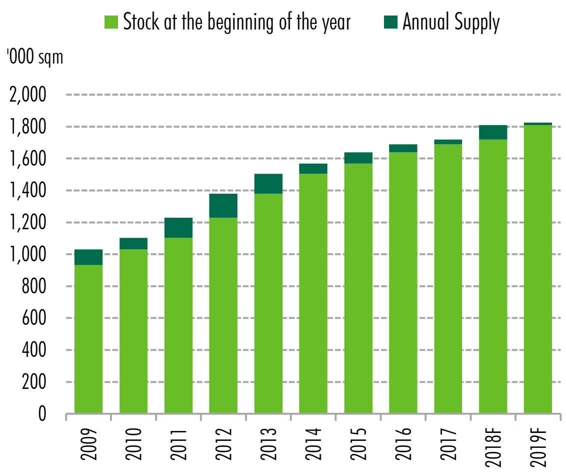


Figure 5: Kyiv Annual Development Completions and Total Competitive Stock ('000 sq m)



Source: CBRE Ukraine
F - Forecast

Regus, an international operator of serviced offices, also opened two locations with the total area of ca. 2,500 sq m, including the 1st Regus space on the Left (East) Bank of Kyiv in Silver Breeze BC. While the trend is global and can be attributed to changes in approach to work organization, it is indicative of accelerating small business and freelance activity in Kyiv.

SUPPLY

In 2017 annual development completions amounted to 31,500 sq m (-28% y-o-y), setting a new record low for the market. More than 90% of new space was concentrated in one business center – Astarta BC (16,100 sq m GLA in Phase I and 12,500 sq m GLA in Phase II). A remarkable factor was that 65% of space was either leased or pre-leased in the whole project as of the end December 2017. Given such minor increase in new supply, total competitive stock grew by just 2% y-o-y to 1.7 mln sq m over the course of the year.
The persistent decline of development activity over the last five years marked the preconditions for an inevitable shortage of quality office space on the horizon. In 2018 90,000 sq m of new supply is expected to be added to the total office stock, which is almost a 3 times increase compared to 2017. However, this increase in the forecast annual volume of new space is mostly attributable to delays in delivery rather than an accelerating development activity in the office sector. Phase I of Unit City (25,600 sq m GLA), office building on Sahaidachnoho St. (10,000 sq m GLA), and Volodymyrska St. (5,200 sq m GLA) were among those projects postponing their delivery until 2018. The only new construction start was that of Europassag BC on Haidara St. (13,000 sq m GLA). As a result, 81,000 sq m of new office space in 9 schemes are under construction and scheduled for commissioning by the end of the year. Additional 9,000 sq m GLA in the business center at 98 Velyka Vasylkivska St. previously offered for sale is expected to enter the leasing market in 2018.

Table 2: New supply in 2017and office pipeline for 2018-2019

NAME	CLASS	ADDRESS	GLA, SQ M	DELIVERY	STATUS
Astarta (Phase I)	AB	58 Yaroslavska St.	16,100	H12017	Stock
Astarta(Phase II)	AB	58 Yaroslavska St.	12,600	H22017	Stock
Forum Westside (Phase III)	BB	6 Oleny Telihy St.	2,800	H12017	Stock
UNIT CITY	AB	1 Dorohozhytska St.	25,600	2018	U/C
Office building	BB	54 Haidara St.	13,000	2018	U/C
Office building	BA	1B P. Sahaidachnoho St.	10,000	2018	U/C
Office building	AA	98 Velyka Vasylkivska St.	9,200	2018	Stock*
Astarta (Phase III)	AB	58 Yaroslavska St.	9,000	2018	U/C
Office building	BA	36 Volodymyrska St.	5,200	2018	Reconstruction
Office building	BA	10 Mykhailivska St.	5,000	2018	U/C
Office building	BA	3 Tsytadelna St.	4,000	2018	Reconstruction
Office building	BC	10-14 Dniprovska Naberezhna	3,500	2018	U/C
K\MOST	BB	5A Zoolohichna St.	5,500	2018	U/C
Office building	BC	47 Pravdy Ave.	11,100	2019	U/C
Office building	BB	14A V.Lypkivskoho St.	2,200	2019	U/C
Office building	BB	44A M. Boichuka St.	2,000	2019	U/C

*the business center was delivered in 2013 for sale; starting from 2018 the property will be offered for lease
Source: CBRE Ukraine

VACANCY

The above mentioned boost in leasing activity substantially reduced the supply of good quality, well located, modern space that leading occupiers seek. Limited new supply supported the trend of declining average market vacancy, which decreased sharply by 10.5 pp reaching 17.5% as of the end of the year. The decrease resulted from the general strengthening of leasing activity and quick absorption of the scant new supply. The distribution of vacant space across submarkets revealed the scarcity of vacant premises in Podil and Prime submarkets of the CBD area, with the lowest indicators of 3.5% (-6 pp YTD) and 4.5% (-7 pp YTD) for these two submarkets respectively as of the end of 2017. Olimpliiskyi submarket witnessed healthy absorption pace of 10 pp YTD standing at 17% as of the end of the year. However, the fastest pace of absorption of vacant space was evident in the CBD-fringe, where vacancy decreased by 16.9 pp YTD and is standing at 10%. Non-central submarkets maintained the highest rate of vacant space (28%), although decreasing vacancy was also a trend here.

RENTS

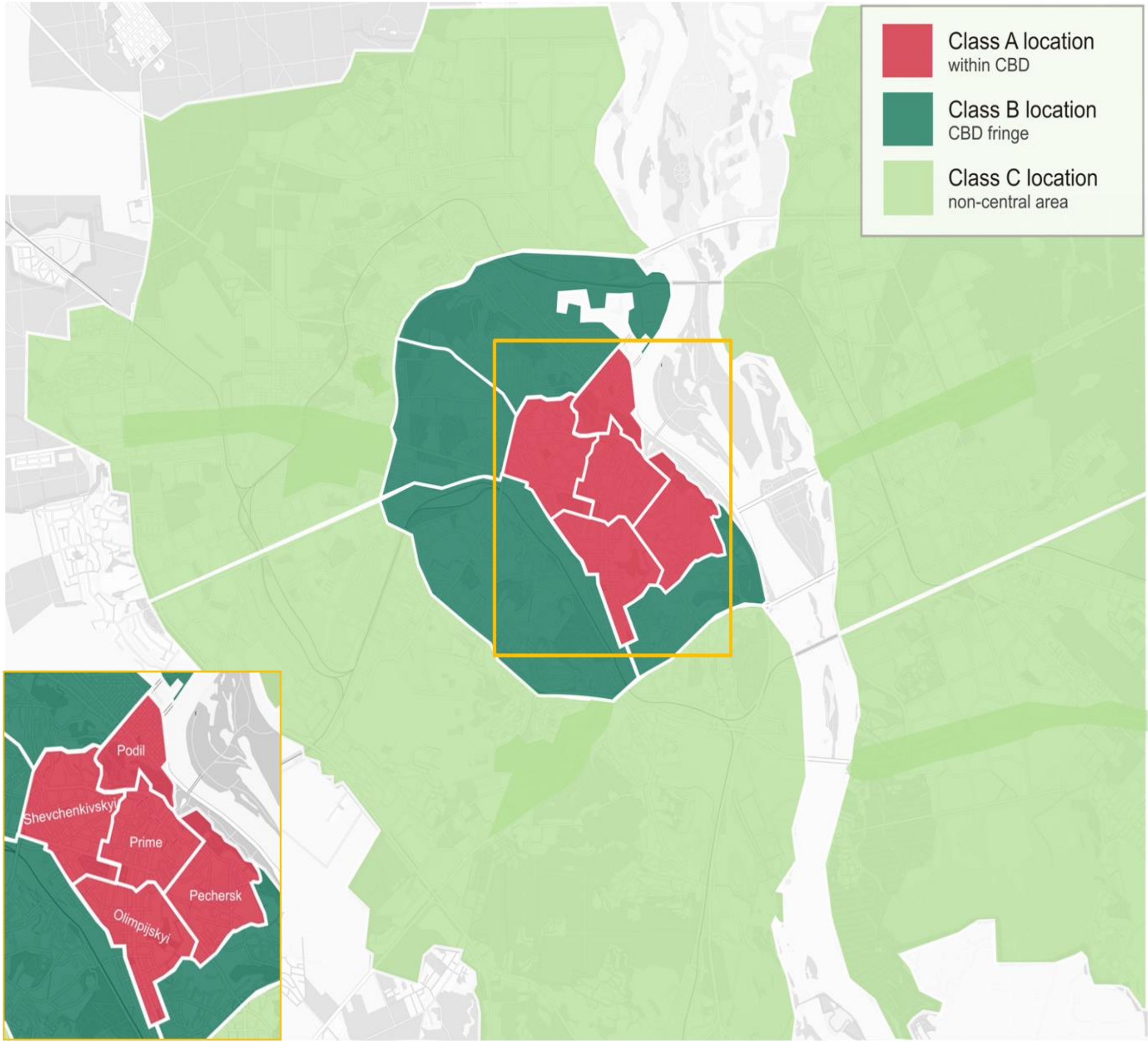
Evidence of gradual growth in asking rates in business centers was recorded at +10%-20%, as landlords felt growing interest from occupiers amid general contraction of vacancy. Asking rental rates traditionally varied in the broad range of $13-$38/sq m/month for A class buildings across submarkets, while B class asking rents were ranging between $8 - $23 sq m/month. Nevertheless, prime effective rent remained generally stable at $23/sq m/month (triple net) during 2017. Effective rents for actual transactions in A class business centers stood within the $13 - $23/sq m/month range. In B class properties rents remained in the $8-$20/sq m/month range.

Table 3: Kyiv Office Asking Base Rental Range, by Location as of Q4 2017 (USD/sq m/month)

Class A location	Quality A	Quality B	Vacancy Q4 2015	Vacancy Q4 2016	Vacancy Q4 2017
Prime	$28-38	$16-23	19.2%	10.2%	4.5%
Pechersk	$16-27	$15-23	46.3%	21.3%	20.9%
Podil	$18-22	$15-20	16.7%	10.4%	3.5%
Shevchenkivskyi	-	$10 -20	20.4%	14.7%	12.6%
Olimpijskyi	$16-35	$14-22	26.9%	26.6%	17.0%
Class B location	**Quality A**	**Quality B**	**Vacancy**	**Vacancy**	**Vacancy**
CBD fringe	$15-32	$11-20	20.1%	26.9%	10.0%
Class C location	**Quality A**	**Quality B**	**Vacancy**	**Vacancy**	**Vacancy**
Non-central area	$13-16	$8-12	42.9%	38.9%	28.0%

Source: CBRE Ukraine

Map of Office Submarkets in Kyiv



Source: CBRE Ukraine

INVESTMENT

Kyiv investment market in the office segment benefited from positive fundamentals in 2017. Robust recovery in occupier demand and sharply declining vacancy pointed towards shortage of quality space and potential for NOI growth. Investors therefore snapped up some core assets in expectation of good upside potential in near to medium term future. Transactions in the office sector dominated the total investment volume, accounting for roughly 75% of total trades. While several small-scale transactions materialized in the office sector, the most pronounced acquisitions of Prime (9,000 sq m GLA) and Eurasia (30,000 sq m GLA) business centers were finalized by Dragon Capital Investments Limited in Kyiv. Owing to a better economic backdrop, healthier occupier demand and improving investor interest in office assets, prime yields compressed by 1pp during 2017, standing at 12.00% for prime office properties.

OUTLOOK

2018 is expected to bring even more pronounced demand for quality office space, thereby driving the fundamentals to a more balanced market. Office leasing volumes are set to post further growth supported by rising confidence of corporate occupiers. We expect continuous improvement in the occupier sentiment, with more cases of expansion and market entry. According to a recent CBRE Ukraine conducted occupier survey, approximately 57% of occupiers are willing to relocate or expand during the next three years. However, current office market will already face challenges to accommodate large requirements of more than 5,000 sq m due to scarcity of vacant space in modern office buildings. Various issues on the corporate agenda relating to the selection, use, and management of office space will come to the fore in 2018. In case no large developments commence, large corporations may consider built-to-suit arrangements or flexible space solutions.

Development activity will remain muted, with no remarkable large-scale projects to be delivered in 2018. Approximately 90,000 sq m of new supply is expected to be available for lease in 2018. The forecast new supply is mostly represented by small-scale office buildings. The largest office schemes under construction include Phase I of Unit City (25,000 sq m GLA), an office building on Sahaidachnoho St. (10,000 sq m) and an office building at Haidara St. (13,000 sq m GLA). 9,000 sq m will come into the market in the previously unfinished office building located at Velyka Vasylkivska St. Should the office construction volume remain curtailed, such trend portends the scarcity of A class office space, particularly that for large occupiers, already in 2018-2019. Nonetheless, the development of medium size schemes of 10-15 thnd sq m is expected to revive, once the average rental rates breach the $20/sm/month threshold, making the development viable.

As positive dynamics of take-up remain, we will continue to witness a decelerating average market vacancy throughout 2018. At the same time, the pace of vacancy contraction will depend on the volume of new additions which are rather moderate. The most likely scenario is that a relatively benign and improving economic environment will continue to spur occupier demand which, in turn, will maintain an upward pressure on rental rates and particularly for the best space. As a result, rents are forecast to post moderate growth of 10%-15% over 2018. This long awaited rental recovery is a fundamental factor for inducing new development or revitalizing previously halted projects, with debt financing remaining an issue.

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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.