Kyiv Warehouse Market, 2017

Scarcity Of Vacant Stock Holds Back Take-up, Spurs Acquisitions And Investment Activity

Total Competitive Stock 1.25 mln sq m (-1.7% y-o-y)

Lease Take-up 120,000 sq m (+9% y-o-y)

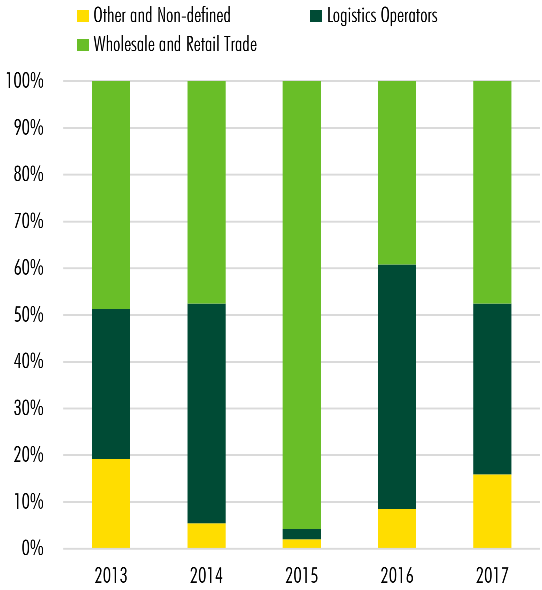
Average Vacancy 6.0% (-6 pp y-o-y)

Prime Effective Rents $4.1/sq m/month (0% y-o-y)

Hot Topics

- Buoyant occupier activity driving take-up to 120,000 sq m (+9% y-o-y)
- Meagre volume of new supply (ca. 9,300 sq m) represented by the extensions of existing properties, while no sizeable new warehouses reached the market in 2017
- Vacancy posting tangible decline from 12% to 6% (-6pp y-o-y)
- Prime effective rents stable at $4.1/sq m/month (net of VAT and OPEX), with asking rents rising by 10%-15% y-o-y
- Improvement in industrial investment activity over the year stimulated by expectation of growth in rental income and capital values

Figure 1: Total Take-up Structure by Industry*



*Volume of transactions
Source: CBRE Ukraine

DEMAND

Demand for warehouse space continued to grow, supported by a steady economic recovery. Annual take-up volume (including end-user acquisitions) reached ca. 120,000 sq m (+9% y-o-y). Although the upward demand trend continued, lease take-up was limited by the availability of warehouse space amid increasing storage requirements from key occupiers. Take-up volume was dominated by large-scale retail occupiers, with ca. 48% in annual take-up structure. The acquisition of Kopylov Logistic park (31,000 sq m) by the Ukrainian discounter retailer ATB from Ghelamco Group accounted for 28% of total take-up, with lettings accounting for the remainder. Logistics operators took the second largest share of the market, at 36%, followed by manufacturers and other industries at 16%.

In 2017 the trend of growing number of expansion requirements started to be more evident across the market. Total expansion of storage space leased totaled ca. 48,000 sq m, with nearly 80% of requirements coming from logistics operators. The largest lease transactions of 2017 included the expansion of ZAMMLER, leasing 11,000 sq m in BF Warehouse 1. Another large expansion was by NP Logistic, fulfillment operator of Nova Poshta, leasing additional 8,600 sq m in Omega 2. Kuehne & Nagel and Rhenus leased new space of ca. 4,500 sq m each in FIM Center and West Gate Logistics, respectively. Thus far, five largest logistic companies Kuehne+Nagel, Raben, ZAMMLER, Ekol, and FM Logistics are occupying nearly 372,000 sq m of warehouse space.

Table 1: Key Lease & Sales Transactions in 2017

OCCUPIER	INDUSTRY	PROPERTY	DIRECTION	SQ M	DEAL TYPE I	DEAL TYPE II
Argo	Wholesale and retail trade	MLP Chaika	Zhytomyr (M-06, E-40)	1,500	lease	relocation
ATB	Wholesale and Retail Trade	Kopylov Logistic Park	Zhytomyr (M-06, E-40)	31,000	sale	sale
Auchan	Wholesale and Retail Trade	UKR DC	Odesa (M-05, E-95)	3,000	lease	expansion
Business Group	3PLs, Transportation	RLC	Chernihiv (M-01, E-95)	4,300	lease	relocation
Business Group	3PLs, Transportation	RLC Fozzy	Chernihiv (M-01, E-95)	4,000	lease	expansion*
Business Group	3PLs, Transportation	RLC	Chernihiv (M-01, E-95)	2,000	lease	expansion
Business Group	3PLs, Transportation	UKR DC	Odesa (M-05, E-95)	1,500	lease	relocation
DSV	3PLs, Transportation	San Factory III	Kyiv	4,100	lease	expansion
Kolo supermarket	Wholesale and Retail Trade	Amtel	M-06/M-05	2,000	lease	new lease
Kuehne+Nagel	3PLs, Transportation	FIM Center	Zhytomyr (M-06, E-40)	4,500	lease	expansion
Malbi	Manufacturing, Industrial & Energy	ICT	M-06/M-05 (Vyshneve)	6,000	lease	relocation
NP Logistic	3PLs, Transportation	Omega-2	Chernihiv (M-01, E-95)	8,600	lease	expansion
Okko retail	Wholesale and Retail Trade	WWM	Sofiivska Borschahivka	5,000	lease	relocation
Rhenus	3PLs, Transportation	West Gate Logistic	Zhytomyr (M-06, E-40)	4,500	lease	expansion
SMK	Manufacturing, Industrial & Energy	Terminal Bucha	Warsaw (M-07, E-40)	5,000	lease	relocation
Studio Moderna	Manufacturer/e-commerce	Komodor	Zhytomyr (M-06, E-40)	5,000	lease	relocation
Viessman	3PLs, Transportation	Amtel	Odesa (M-05, E-95)	1,300	lease	relocation
Yug Kontrakt	Wholesale and Retail Trade	MLP Chaika	Zhytomyr (M-06, E-40)	6,000	lease	expansion
ZAMMLER	3PLs, Transportation	BF Warehouse I	Kharkiv (M-03, E-40)	11,000	lease	expansion

* leased new space in ambient warehouse; before the company expanded within chilled storage facilities
Source: CBRE Ukraine

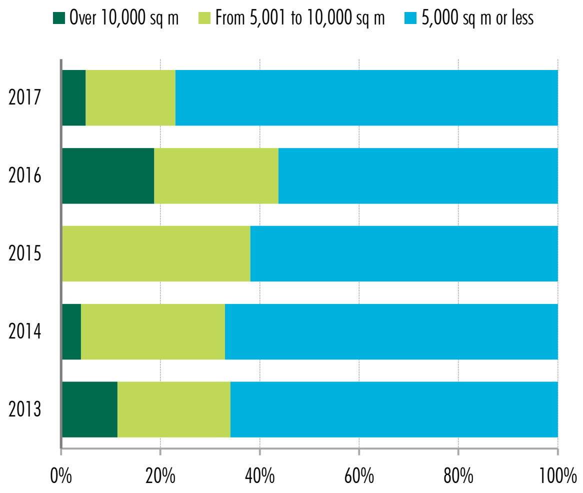
However, the retail sector, particularly food retailers, remained the initial driver of demand for warehouse space. As of the end of 2017, roughly the same volume of 388,000 sq m of storage facilities was occupied (either leased or owned) by food retail chains Fozzy Group, ATB, Auchan, EKOmarket, and Velyka Kyshenia. Due to the emerging shortage of large units for lease, the largest space requirements were mainly satisfied either through acquisitions or expansion within serving logistic operators. Only small scale retailer expansions were realized through direct lease: after substantially expanding its occupied space in East Gate Logistics in 2016, Auchan leased additional 3,000 sq m in cold storage UKR DC warehouse. As an example of expansion within the logistic operator, the most notable such expansion was that of METRO C&C growing by ca. 14,000 sq m within FM Logistic warehouse in H12017.

Table 2: Top Largest Occupiers in Kyiv & Ukraine

TOP 5 OCCUPIERS: RETAILERS	
NAME	OCCUPIED SPACE, SQM
Fozzy Group	160,000
ATB	150,000
Auchan	42,000
Velyka Kyshenya	23,000
EKO market	13,000
TOP 5 OCCUPIERS: LOGISTICS COMPANIES*	
NAME	OCCUPIED SPACE, SQM
Kuehne+Nagel	122,600
ZAMMLER	75,000
Raben	73,000
Ekol	58,000
FM Logistic	43,000

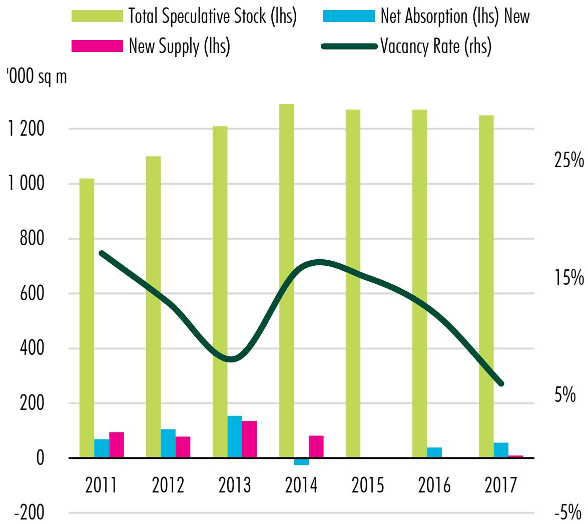
*total occupied space, including leased & owned warehouse premises, as well as servicing Clients on their warehouse facilities
Source: CBRE Ukraine

Figure 2: Lease Take-up Structure by Transaction Size*



*number of lease transactions

Figure 3: New Supply, Net Absorption and Vacancy Rate



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

Looking into the lease take-up by transaction size, small deals (5,000 sq m or less) dominated the take-up comprising 77% in the total volume. At the same time, the share of large-scale transactions in excess of 10,000 sq m continued to shrink, with only one notable lease recorded in 2017. Such trend resulted from shortage of appropriate size units among existing supply. Thus, while the deferred demand continued to grow, the deficit of warehouse space started to limit the actual take-up.

SUPPLY

In 2017 annual new supply amounted to ca. 9,300 sq m represented by extensions of existing warehouses, while no new projects were delivered to the market. The mini-addition to the stock was comprised of Phase III (4,100 sq m), Phase IV (1,100 sq m) of SAN Factory in-city warehouse, and 4,100 sq m in Schastlyve 2. Total speculative stock decreased by 1.7% to 1.25 mln sq m as of the end of 2017, due to the acquisition of Kopylov Logistic Park (31,000 sq m) along with small volume of new additions. The trend of increasing development completions in the owner-occupied sector continued in 2017, accounting for 79% of total annual new supply. With the delivery of Terminal Nova Poshta (20,000 sq m) and Phase III of FM Logistic - Sections 5 & 6 (14,000 sq m), total annual new supply for owner-occupation reached ca. 34,000 sq m.

Table 3: Key Warehouse Schemes in 2017-2018

NAME	DEVELOPER	WAREHOUSE PREMISES, SQ M	STATUS	COMPLETION
SAN factory (Phase III)	Sky Development	4,100	Delivered	H12017
Schastlyve 2	Local developer	4,100	Delivered	H12017
SAN factory (Phase IV)	Sky Development	1,100	Delivered	H22017
FM Logistic Section 5 (Phase III)*	FM Logistic	7,000	Delivered	H12017
FM Logistic Section 6 (Phase III)*	FM Logistic	7,000	Delivered	H22017
Terminal Nova Poshta*	Nova Poshta	20,000	Delivered	H22017
Unilogic Park III	MERX	22,000	Under Construction	2018
Mirazh 3	Mirazh	9,000	Under Construction	2018
Amtel (Phase II)	Amtel Properties	52,000	Project	2019

*for owner occupation
Source: CBRE Ukraine

The volume of new speculative warehouse space currently planned for commissioning in 2018 amounts to modest ca. 31,000 sq m in Phase lll of Unilogic Park (22,000 sq m) previously postponed from 2017, as well as completion of Mirazh 3 warehouse scheme in Hostomel (9,000 sq m), construction of which was commenced at the end of 2017. Furthermore, we expect that occupier requirements for large units in excess of 20,000 – 30,000 sq m will be materialized in build-to suite arrangements in the coming 12-24 months.

VACANCY

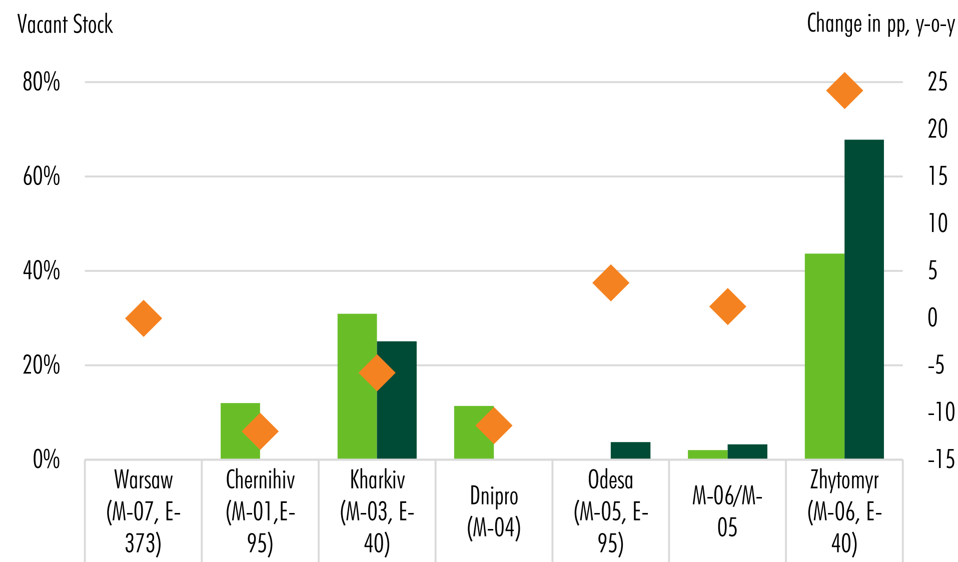
Rising occupier demand, limited new supply, and shrinking speculative stock altogether put a noticeable downward pressure on vacancy. While the shortage of quality warehouse space became even more evident in the second half of 2017, average market vacancy decreased further by 6pp from 12% to 6% over the course of the year. 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, Chernihiv (M-07, E-373) and Dnipro (M-04) Highways experienced the highest take-up, with vacancy contracting by -12pp y-o-y and -11pp y-o-y respectively, with no available space remaining by the end of 2017. 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 M-05 Highways (17%).

RENTS

Asking rents posted moderate growth of 10% - 15%, reaching UAH120 – UAH140 ($4.4 - $5.2 /sq m/month) in A-class warehouse properties. Actual rents for professional warehouse space were generally stable during the year: prime rent for top-quality properties remained at $4.1/sq m/month, varying between $3.0 and $4.1/sq m/month (UAH85 - UAH110/ sq m/month) on average for A-class warehouses. Rents for B-class warehouses stood in the $2.3 - $3.0/sq m/month range (UAH60 - UAH80/sq m /month).

Figure 4: Vacant Stock Distribution by Highways*



	Warsaw (M-07, E-373)	Chernihiv (M-01,E-95)	Kharkiv (M-03, E-40)	Dnipro (M-04)	Odesa (M-05, E-95)	M-06/M-05	Zhytomyr (M-06, E-40)
Vacant stock 2016 (lhs)	0%	12%	31%	11%	0%	2%	44%
Vacant stock 2017 (lhs)	0%	0%	25%	0%	4%	3%	68%
Chanage in pp, y-o-y (rhs)	0	-11,98	-5,77	-11,38	3,77	1,23	24,13

lhs – left hand side; rhs – right hand side
*base – total volume of vacant space
Source: CBRE Ukraine

Rising energy costs, land taxes, and nominal wages stipulated a sizeable increase in operating expenses (OPEX). In most warehouse properties OPEX grew by 10% - 20%, standing between $0.5 and $0.6/sq m/month (UAH12-UAH15/sq m /month) net of VAT as of the end of 2017.

INVESTMENT

The investment sentiment continued to improve in industrial segment, owing to already visible market imbalance, with robust growth of occupier demand outpacing supply in 2017. Hence, the warehouse market witnessed a healthy investor interest as a result of a growing number of investment transactions closed in the industrial sector in 2017. Among the most notable deals are several acquisitions by Dragon Capital Investments Limited, namely Diana Lux (15,000 sq m; M-01, E-95), Terminal Bucha (32,000 sq m; Bucha), and Prologistic Service (10,000 sq m; Hostomel) warehouses.

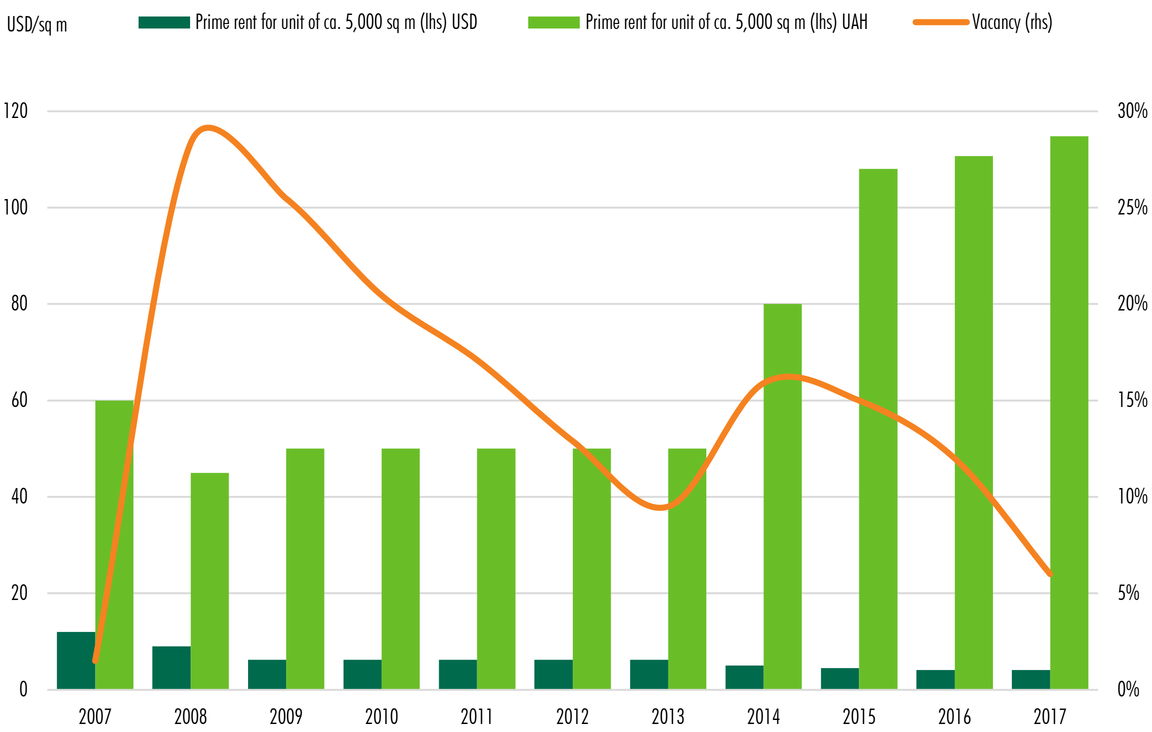
On the back of better market fundamentals and improving investors sentiment in 2017, yields for prime warehouse assets compressed by 1.75 pp y-o-y standing at 13.75% as of the end of 2017. We expect the investment activity to continue the upward trend, provided no downward economic swings take place in the meantime. The shift from the tenant's to the landlord's market are setting stage for rising rental rates and compressing yields for industrial assets in the next 12-24 months.

OUTLOOK

In light of generally more positive economic outlook for 2018, we expect continued increase in demand for warehouse space from logistic, retail, and e-commerce. The take-up is likely to be driven by expansion intensions supporting healthy absorption pace. However, the actual take-up growth will be much more dependent on the amount of new speculative supply, as physical space availability remains very constrained.

Notwithstanding the low volume of new supply along with rising demand, the development activity in the segment remained scant.

Figure 5: Rental and Vacancy Rates, as of the end of 2017



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

Taking into account the rescheduling of Unilogic Park III (22,000 sq m) delivery to 2018, a meagre 31,000 sq m of new supply is currently in pipeline for the full year ahead, with the expected demand in the region of 150,000 sq m. All new supply is therefore bound to be quickly absorbed and new development cycle should recommence. In view of the imbalance between supply and demand, the second phase of Amtel warehouse of 52,000 sq m is likely to be brought back into the development pipeline, although developer has not made any such announcement yet. However, while the market fundamentals demonstrate the necessary preconditions for decline in vacancy down to almost naught and growth of rental rates, the next cycle of the development activity continues to be held back by absence of any meaningful development financing.

Considering the immense volume of space requirements that have not been fulfilled in 2017, the deferred demand is likely to put upward pressure on rents in the coming months. Rents for A class warehouses are forecast to post minor growth of 10%-15%, provided no significant currency fluctuations. On the investment side, the appetite for good industrial investment opportunities should remain strong, buoyed to some extent by expectations of rental growth in this sector, as well as growing space requirements coupled with very low availability vacant of space.

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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**