Kyiv Office Market

Prime Rent Echoes Disruption in Leasing Momentum

Take-up ▼
42,000
sqm (-42% y-o-y)

Vacancy ▲
12.4%
(+3.9 pp YTD)

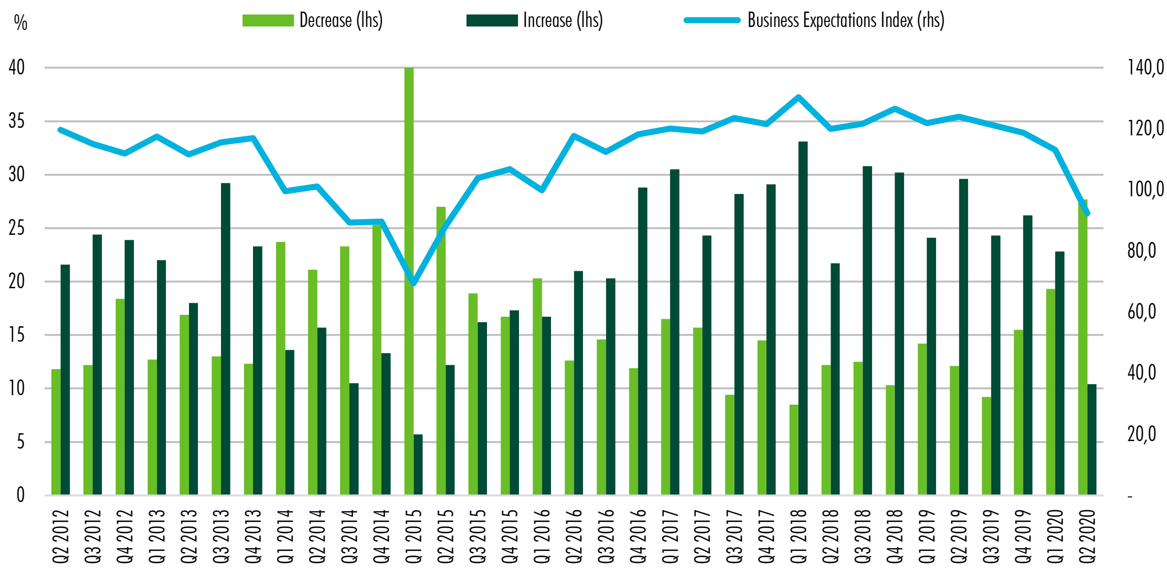
Prime Rent ▼
$25
sqm/month (-7% YTD)

Demand

The Kyiv office market was seeing a strong first quarter of 2020 until the beginning of lockdown in March. As Ukraine grappled with the impact of COVID-19, by the end of Q2 GDP shrank by 9.9% q-o-q and 11.4% y-o-y, affecting business activity across the country (Preliminary data by State Statistics of Ukraine). Unemployment rate in Kyiv reached 6.8% in Q1 2020, 0.6pp up on 2019 but down 0.2pp on the 5-year average. According to the Ministry of Economics of Ukraine, in Q2 employment levels took an even greater hit from the lockdown, although unemployment rate started to gradually bounce back towards the end of June (data yet to be published).

According to the Q2 2020 survey by NBU (conducted between May and June), only 10% of companies were looking to increase their workforce over the next 12 months, pointing towards a cyclical softening in white-collar industry employment. The slowing economy also prompted ca. 28% of companies to plan for tightening of their headcount in the following 12 months, with ca. 62% expecting no changes in staff. Index of Business Expectations in Q2 in Kyiv posted a downward movement of 20.7 pp YTD, reaching 92.4 amid COVID-19 outbreak, concurrent with increased financial and political risks. This kind of low has not been seen since 2015, as businesses were quick to downgrade expectations in view of prior experiences.

Figure 1: Kyiv Business Expectations and Corporate Hiring Expectations Over the Next 12 Months



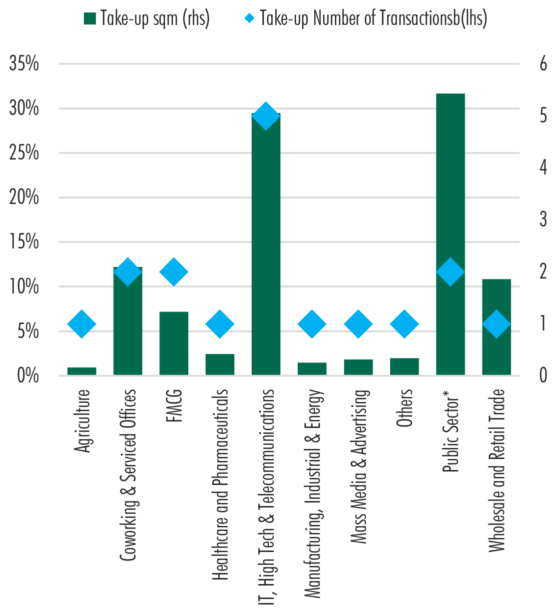
Source: Source: NBU; Lhs – left hand side; Rhs – right hand side

Leasing transactions were muted in Kyiv, bringing the total take-up for the half year to ca. 42,000 sqm, which is 42% down on this point last year. Lease transactions were mainly driven by the need of companies to upgrade offices, with few strategic decisions of this kind reflecting COVID considerations in such a short time. In Q2, in particular, the market witnessed several quick contractions among IT occupiers, such as EPAM and SoftServe, who had contractual opportunity to reduce office footprint during this time. The largest transaction to complete in H1 2020 was a 7,800 sqm lease by Vodafone in Sigma BC, as part of the company's consolidation strategy – moving multiple small-to-medium offices into one large non-central location. The largest share of take-up was concentrated within CBD submarket with ca. 46%, followed by Non-central with 38%, and CBD fringe with 16%. Non-central locations are becoming more demanded, as companies try to reduce commute times of their employees who usually travel to the office from suburban residential districts. Data from TomTom Traffic Index show that street congestion in Kyiv increased by 7% in pre-pandemic 2019, making it the 12th most congested city in the world and 3rd in Europe.

When looking at demand composition, to date this year considerable share of demand has come from the IT Services sector (ca. 29% of take-up). In addition to Vodafone, another sizeable transaction was the relocation of international IT company (1,500 sqm) to Astarta BC. Also, one end-user sale transaction was registered in Q2 2020 take-up, as Deposit Guarantee Fund of Ukraine purchased the ex-office building of Nadra Bank (11,200 sqm) at 17 Sichovyh Strilstiv St for own occupation. As owner-occupied purchases are included in take-up, this transaction drove the share of Public Sector in take-up for the period to 32%.

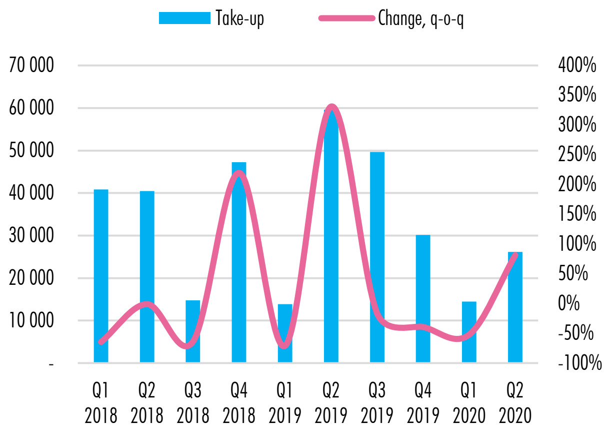
Occupiers from the segments of Coworking & Serviced Offices and Wholesale & Retail accounted for ca. 12% and 11% of take-up, respectively. Despite a low share of Coworking & Serviced Offices in this semi-annual take-up, the structural shift towards flexible office solution is taking an ever-increasing share of the market

Figure 2: Total Known Take-Up Structure by Industry in H1 2020



*One large owner occupied sale drove the share of the segment
Source: CBRE Ukraine

Figure 3: Kyiv Take-Up by Quarter, 2017-2020



Source: CBRE Ukraine

every year, as the gig economy is taking shape in Kyiv, and the market in general is feeling the need for an ever-greater flexibility. The more traditional lease is typically the choice of large corporate occupiers who are used to planning their workplace strategies for the long term. But the COVID-19 pandemic may become a considerable milestone in shaping the direction of development of traditional offices and workplace planning in general. According to the COVID-19 Impact on Office Lease Terms survey by CBRE Ukraine, just above half of the respondents (51.1%) were considering the possibility of partially or completely switching to remote work in the future, while 47.9% were not ready to make such decision.

Therefore, even though mass working from home was broadly successful globally, offices still play a vital role in socialising and community building. Hence, a hybrid workplace model is likely to emerge – a combination of main office, co-working space and home office.

Supply

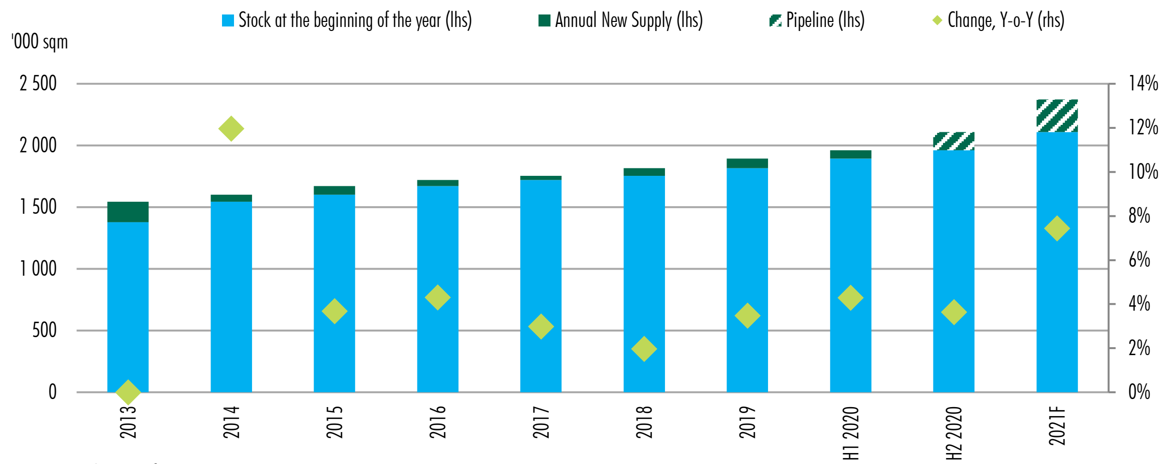
Despite a broad impact the pandemic has had on the office market, the development cycle will take years to react and adjust to the new realities. Whereas long term plans have been mostly put on hold, projects at advanced stages of completion have proceeded forward. A number of office schemes have been delivered to the market as of the end of Q2 2020, amounting to 69,100 sqm in total, which is significantly up from 30,600 sqm completed at this point last year. The key projects include: Avenue 53 (18,500 sqm), Forum Park Tower (11,500 sqm), M8 (11,000 sqm), Hillfort Business Mansion (8,600 sqm), Forum Infinity (8,500 sqm), Nyvky City (7,200 sqm), and Arsenal K-14 (3,800 sqm). At the end of H1 2020, total competitive stock stood at 1.96 mio sqm, edging upwards by 3.6% YTD. At the same time, options which could provide an occupier with 10,000 sqm or more still remain scarce, creating a strong demand for new developments with floor plans of over 1,500 sqm and contiguous units of 5,000-10,000 sqm. The total amount of Grade A and B space announced for delivery by the end of 2020 was ca. 146,300 sqm; however, given a weaker occupier sentiment registered in H1 2020, delays in construction deliveries are possible. Moreover, as majority of new projects at early development stages were put on hold or chalked off altogether, new deliveries are likely to dry up again in the 2023-2024 period.

Table 1: Key Office Lease Transactions in H12020, >1.000 sqm

OCCUPIER	INDUSTRY	PROPERTY	ADDRESS	TRANSACTION TYPE	GLA SQ M
Deposit Guarantee Fund of Ukraine	Public Sector	Nadra Bank Office Building	17 Sichovyh Stritsiv St.	Acquisition & Occupation	11,200
Vodafone	IT, High Tech & Telecommunications	Sigma	6 Vatslava Havela Blvd.	Expansion	7,800
Novus HQ	Wholesale and Retail Trade	Retroville	47 Pravdy Avenue	Relocation & Expansion	4,000
Platforma	Coworking & Serviced Offices	Leonardo I	17/52 Bohdana Khmel'nyts'koho St	Expansion	2,800
NDA	FMCG	Confidential	Confidential	Relocation	2,200
Regus	Coworking & Serviced Offices	Avenue 53	53 Peremohy Avenue	Expansion	1,700
NDA	IT, High Tech & Telecommunications	Astarta	58 Yaroslavska St.	Expansion	1,500

Source: CBRE Ukraine

Figure 4: Kyiv Annual Development Completions and Total Completions Stock ('000 sqm)



Source: CBRE Ukraine, F-forecast

Table 2: Office Pipeline for H2 2020-2022

NAME	CLASS (QUALITY & LOCATION)	ADDRESS	GLA, SQM	STATUS	DELIVERY
UNIT.City B11 (B4)	AB	3 Dorogozhytska St.	5,100	U/C	2020
K\MOST	AB	5A Zoolohichna St.	5,500	U/C	2020
Retroville	BC	47 Pravdy Ave.	11,100	U/C	2020
Platforma (Fabrika Voronin) I	AA	3 Korolenkivska St.	19,500	Reconstruction	2020
Office Scheme (D/Z21H)	AB	21H Dehtiarivska/ Zoolohichna St.	11,000	U/C	2020
Office Scheme (K4-6) I	AA	4-6 Korolenkivska St.	20,000	U/C	2020
Zoranyi	BA	31/33 Moskovska St.	7,800	Reconstruction	2020
Lukianivskyi (ex-Topaz)	BB	2/10 Y. Illienka St.	22,000	U/C	2020
Office Scheme (H4)	BC	4 Harmatna St.	12,400	Reconstruction	2020
Office Scheme (S26/14)	BA	26/14 Spaska St.	9,400	U/C	2020
Eleven III	BB	11 Solomianska St.	16,500	U/C	2020
Office Scheme (Pr8A)	AA	8A Prorizna St.	6,000	Reconstruction	2020
UNIT.City (B14)	AB	3 Dorogozhytska St.	8,900	U/C	2021
UNIT.City (B15)	AB	3 Dorogozhytska St.	7,700	U/C	2021
UNIT.City (B0)	AB	3 Dorohozhytska St.	7,600	U/C	2021
UNIT.City (B18)	AB	3 Dorohozhytska St.	18,900	U/C	2021
Magnett I	AB	137-139 Velyka Vasylkivska St.	33,000	U/C	2021
Magnett II	AB	137-139 Velyka Vasylkivska St.	10,000	U/C	2021
Office Scheme (K4-6) II	AA	4-6 Korolenkivska St.	60,000	U/C	2021
Portal	BB	71 Kostiantynivska St.	34,500	Project	2021
Protasiv Business Park	BB	2/1 Mykoly Hrinchenka St.	58,700	New concept	2021
Office Scheme (L16)	BB	16 Lavrska St.	15,000	Reconstruction	2021
Andriyivsky Business Space	AA	19 Andriivska St.	9,600	Reconstruction	2021
UNIT.City (B16)	AB	3 Dorogozhytska St.	9,100	U/C	2022
UNIT.City (B17)	AB	3 Dorogozhytska St.	12,400	U/C	2022
ITT Plaza	AA	16-20,22 Korolenkivska St.	77,000	U/C	2022
UNIT.City (B1)	AB	3 Dorohozhytska St.	12,000	U/C	2023
UNIT.City (B2)	AB	3 Dorohozhytska St.	7,800	U/C	2023
UNIT.City (B3)	AB	3 Dorohozhytska St.	9,600	U/C	2023
UNIT.City (B18)	AB	3 Dorogozhytska St.	18,900	U/C	2023

Source: CBRE Ukraine

Vacancy and Rents

At the end of H1 2020, average vacancy rate stood at 12.4%, which is up on Q4 2019 by +3.9pp. Prime (+9.5pp) and Olimpiiskyi (+4.7pp) submarkets in CBD registered the most considerable increases in vacancy, followed by an uptick in CBD-fringe (+5.6pp) vacancy. Such a rise in available current stock can be mainly attributed to COVID-19-related lease surrenders and expiries. Thus, combination of an increased supply and continued cautious approach to leasing over the next 6-12 months is bound to lead to a steadily rising vacancy. At the end of H1 2020, the net average asking rent in Kyiv was **$28/sqm/month** for Grade A space, lying within the typical asking range **of $25-$35/sqm/month** (-22% YTD decrease in upper bound and -4% YTD decrease in lower bound). Prime rent was down by 7% YTD to **$25/sqm/month.** The net average Grade B asking rent **was $18/sqm/month**, within the asking range of **$12-$26/sqm/month** (-17% YTD decrease in upper bound and -29% YTD decrease in lower bound). Significant gap between the lower and upper bounds of the ranges is determined by parameters of the leased unit, fit-out condition, location of the property and overall building vacancy. Exceptional rare cases, such as available premises with ultra-expensive fit-out and furniture, were excluded from the calculations to prevent data being skewed.

Vacancy Rate (%) by Kyiv Office Submarket as of the end of H1 2020

Submarket	H1 2020	2019
CBD		
OLIMPIISKYI	17%	12.1%
PECHERSKYI	2%	2.7%
PODILSKYI	8%	5.6%
PRIME	19%	9.9%
SHEVCHENKIVSKYI	9%	8.0%
CBD-fringe	9%	3.3%
Non-central	23%	19.2%

Source: CBRE Ukraine

Figure 5: Kyiv A-class Asking Base Rental Range[1] by Submarket as of the end of H1 2020 (USD/sqm/month)

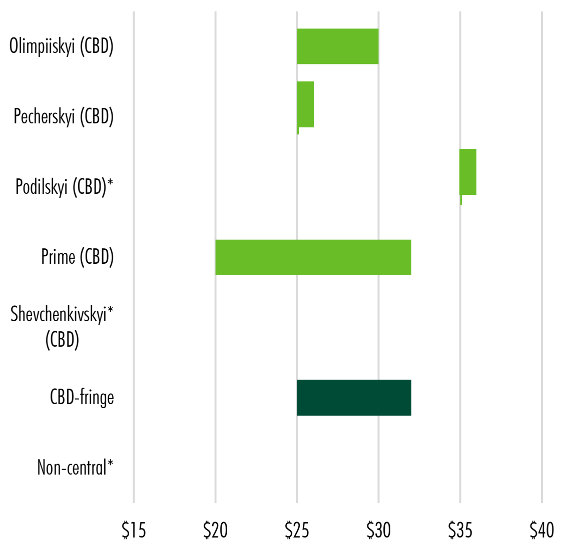
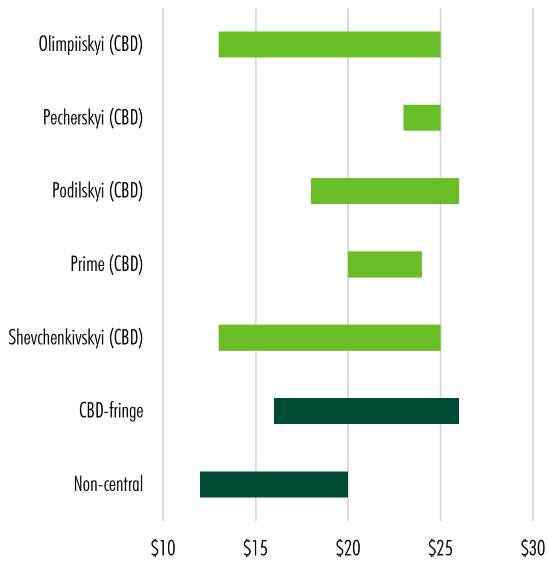


Figure 6: Kyiv B-class Asking Base Rental Range[1] by Submarket as of the end of H1 2020 (USD/sqm/month)



[1]Range includes office space for lease in different fit-out conditions
* No vacant premises as of research date
Source: CBRE Ukraine

Investment

Similar to the leasing market, investment activity was also sharply down during H1, primarily due to the COVID-19 effects. Total commercial real estate investment turnover in Kyiv declined drastically, with no transactions completed in the office sector. However, the drop in volume appears to be a global trend. Among finalised non-investment and somewhat related to the office sector transactions was the purchase of an office building (4,440 sqm) by Dragon Capital Investments Ltd for Kyiv School of Economics. On top of the pandemic-driven economic turmoil, the resignation of the NBU Governor Yakiv Smoliy caused additional shockwaves in the political and business communities of Ukraine, with some players even postponing their investment activities on the market for an indefinite period. This increased uncertainty on the financial market, additionally affected both local and foreign investor confidence, in the short term at least. In response to a volatile and riskier market, office prime yield weakened to 12% (+0.25pp YTD), from the low of 11.75% registered at the end of 2019.

Outlook

The uncertainty of planning the use of office space in the current climate is bound to have an impact on take-up going forward. More occupiers are expected to start reassessing their workplace strategies, with an ever-greater focus placed on work-from-home provisions vs the traditional work-from-office arrangements. The market is already seeing some of the companies changing their relocation and expansion plans, and at least partially switching towards coworking facilities and remote work. Subleasing may become an upcoming trend, as tenants are likely to continue reducing their office footprint, with a view to cutting costs and optimizing teamwork. The projected delays in development pipeline will also result in constraints on supply for large, primarily IT sector occupiers, who are already struggling for options. Such situation will continue to maintain a healthy market for large lot pre-lets for the foreseeable future. Vacancy may continue to creep upwards as new supply enters the market; however, no drastic spikes in vacancy or dips in rental rates are projected in the short-term, as the market is expected to maintain a generally balanced vacancy and sustainable rental rates.

The investment activity is anticipated to remain comparatively subdued in the short term, but the early signs of renewed investor interest are pointing towards reasonable investment activity in the medium term, with COVID-19-related uncertainty priced in. Yield compression is not projected to start before the end of H2 2020 and the beginning of 2021, initially in the core and less risky assets.

CONTACTS

For more information regarding this Market Report, please contact:

Sergiy Sergiyenko
Managing Partner
e: sergiy.sergiyenko@cbre-expandia.com

Radomyr Tsurkan
Managing Partner
e: radomyr.tsurkan@cbre-expandia.com

Diana Starunchak
Head of Marketing and Research
e: diana.starunchak@cbre-expandia.com

Anzhelika Arzumanian
Senior Analyst
e: anzhelika.arzumanian@cbre-expandia.com

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DEFINITIONS (in alphabetical order)

CBD – central business district

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. For offices, the **prime rent** should represent the typical "achievable" open market headline rent which a blue chip occupier would be expected to pay for:

- an office unit of standard size commensurate with demand in each location, typically 500 sqm
- an office unit of highest quality and specification within the local market
- an office unit within the prime location (CBD, for example) of a market

Net Average Asking Rent – represents the weighted average asking rental rate for all known available space in existing competitive buildings at the survey date.

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 – represents the total completed space (occupied and vacant) in the private sector at the survey date, recorded as gross leasable 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.

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**