Kyiv Warehouse Market, H1 2020

The Rise of E-Commerce Begs for New Projects in the Pipeline

Take-up ▼
59,000
sqm (-9% y-o-y)

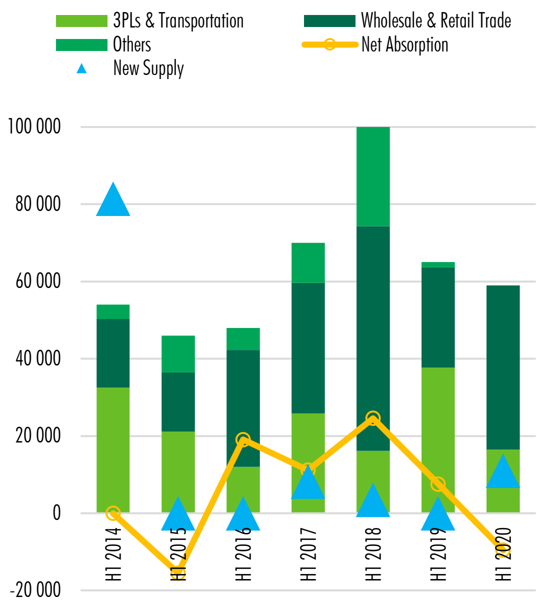
Vacancy ▼
4.2%
(-1.7 pp YTD)

Prime Rent ▲
$5.6
sqm/month

Demand

Kyiv's warehouse market demonstrated the best resilience to the pandemic-caused turmoil among key CRE segments. Sound occupier activity was recorded in the first half of 2020, resulting in completion of 7 key transactions. However, the overall take-up totaled ca. 59,000 sqm, down by 9% vs. the same period last year. Despite positive occupier sentiment during the first half of 2020, a number of vacated premises on the market outweighed total expansions, resulting in negative net absorption YTD. The shift from offline to online retail had a ripple effect into the warehouse market, leading to: Epicenter-K expanding their operation with Viskozna Fulfillment Centre (20,000 sqm), expansion of Rozetka (10,000 sqm) in Enerhoprylad Warehouse, expansion of Fozzy (7,300 sqm) in RLC Pobeda, and relocation and expansion of Business Group (2,300 sqm) in BF Terminal ll. The take-up volume of known transactions in the first half of 2020 was split between Wholesale & Retail Trade and 3PL & Transportation occupiers, accounting for 72% and 28%, respectively.

Figure 1: Semi-annual Take up, Net Absorption, New Supply H1 2014-H1 2020



*New supply in 2020 was the result of Falbi warehouse entering speculative market and Epicenter-K retail premises conversion
Source: CBRE Ukraine

The geographical structure of take-up revealed that the two largest shares – 40.1% and 37.2%, respectively – were taken up in the direction of Chernihiv (M-01) and within inner-Kyiv. The latter share was, for major part, shaped by the conversion of retail premises of Epicentre-K into Epicenter Fulfillment Center Viskozna at 4 Viskozna Str. The center was designed to simplify current logistics processes with automation and increase the speed of online order processing. In terms of other highways, 15.2% of take-up was registered in Ovruch (P-02), 4.3% in Kharkiv (M-03), and 3.2% in Odesa (M-5) directions. Strong occupier focus in the Chernihiv (M-01) direction is mainly attributed to the concentration of warehouse supply in Brovary, a satellite town near Kyiv. Brovary is an important industrial hub with a relatively easy transportation connection and Grade A storage facilities, which makes it a close-to-best alternative to currently scarce in volume urban warehouse facilities. Despite limited number of vacant quality warehouses, demand for Grade A storage facilities across Kyiv remains robust and gathered 78% of H1 2020 demand volume.

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Table 1: Key Lease & Sales Transactions in H1 2020

OCCUPIER	INDUSTRY	PROPERTY	CLASS	DIRECTION	SQ M	TYPE I	TYPE II
Epicenter-K	Wholesale & Retail Trade	Epicenter Fulfillment Center Viskozna	A	inner-Kyiv	20,000	Switch of purpose from retail to logistics	Expansion
Rozetka	Wholesale & Retail Trade	Energoprilad/Amos	A	Chernihiv M-01 E-95	10,000	lease	Expansion
Business Group	3PLs & Transportation	Logistic Invest	A	Ovruch P-02	8,200	lease	Expansion
Fozzy	Wholesale & Retail Trade	RLC Peremoha	B	Chernihiv M-01 E-95	7,300	lease	Expansion
UVK	3PLs & Transportation	Unilogic Park II	B	Chernihiv M-01 E-95	4,300	lease	Expansion
Business Group	3PLs & Transportation	BF Terminal II	A	Kharkiv M-03 E-40	2,300	lease	Relocation & Expansion
Sante Alko	Wholesale & Retail Trade	ABC Khotov	A	Odesa M-05 E-95	1,700	lease	Relocation

Source: CBRE Ukraine

Supply

Delay in existing projects under construction resulted in no newly built supply in H1 2020. With rental rates highly sensitive to fluctuations in the UAH/USD exchange rate, developers are becoming more cautious in times of increased uncertainty. Stable rents denoted in USD are key for warehouse development to satisfy the required rate of return, especially considering the fact that no development financing is available on the market. Hence, the previously expected delivery dates have been pushed back. Nonetheless, Falbi Pharm Logistics Complex entered the speculative market with ca.11,000 sqm of vacant areas after a change in the ownership of the warehouse. In addition, the change of purpose of Epicenter-K premises from retail to logistics at Viskozna Str added ca. 20,000 sqm to total stock. The total competitive stock thus ticked upwards by 2.5% to ca. 1.46 mio sqm.

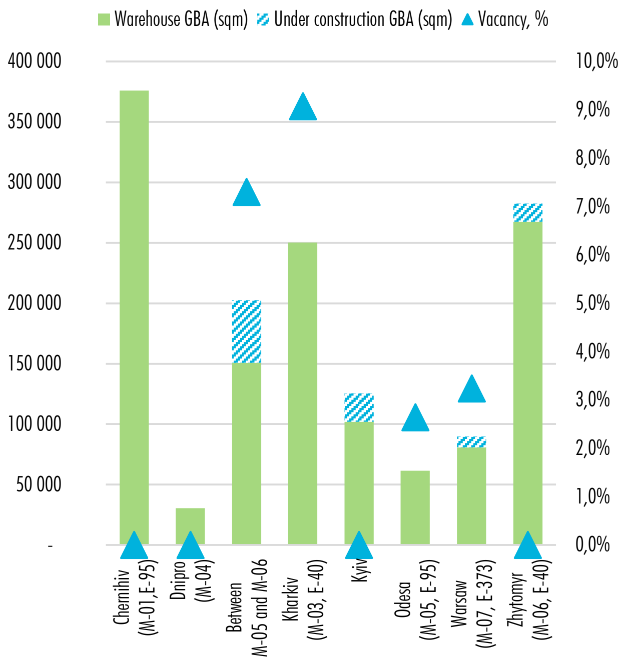
Geographically, the largest volumes of speculative stock remain concentrated along Chernihiv (M-01), Zhytomyr (M-06) and Kharkiv (M-03) directions. The most considerable portion of stock currently under construction (52,000 sqm of Amtel ll) is expected between highways M-05 and M-06 near Boiarka. However, close to 0% vacancy figures in inner-Kyiv as well as in the direction of Chernihiv (M-01) and Zhytomyr (M-06) suggest that there is high demand for storage facilities specifically along these highways. At the same time, interest in urban warehouses is trending upwards amid growing competition in the e-commerce sector and the battle for short order delivery times. But only ca. 23,400 sqm of known supply under construction was pipelined within city limits, leading to potential pent-up demand for in-city located warehouses.

Table 2: Key Warehouse Schemes in the Pipeline for 2020-2021

PROPERTY NAME	DEVELOPER	AREA (SQM)	STATUS	ANNOUNCED COMPLETION	DIRECTION
Amtel II	Amtel-Properties	52,000	U/C	Q4 2020	Boiarka (T-1012)
Makarovskyi Warehouse	ADG	15,000	U/C	2020	Zhytomyr (M-06/ E-40)
Mirazh 3	Mirazh	9,000	U/C	2021	Warsaw (M-07/ E-373)
SAN Factory 2	SkyLine Development	23,400	U/C	2021	Kyiv

Source: CBRE Ukraine

Figure 2: Stock, Under Construction and Vacancy by Highways, H1 2020



Source: CBRE Ukraine

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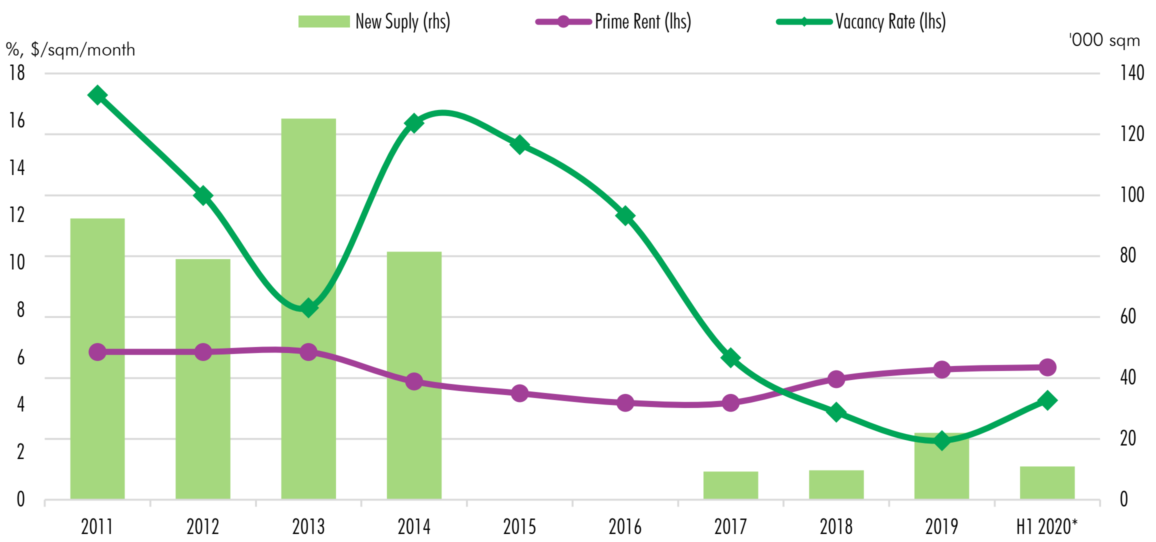
The overall H2 2020-21 pipeline is expected to bring almost 100,000 sqm of competitive supply in anticipation of continued strong demand for warehouse premises from primarily food retail and e-commerce-related businesses. Although developers recognize the need for new supply on the market, absence of debt financing causes ongoing delays in construction, especially of large-scale speculative projects. However, noteworthy is the fact that in June 2020 the NBU cut the key policy rate to the record low of 6% per annum on the back of contained inflation rate and the IMF 18-month stand-by arrangement. Although the compression of key policy rate is far from being the sole trigger of mortgage lending renewal, it is the first step towards more affordable credit rates. Imminent changes in credit rates are unlikely to happen, especially in the midst of the pandemic; however, the scene is set for improvements in the years to come.

Vacancy & Rents

The addition of Falbi warehouse to the speculative market, alongside several market contractions brought the average vacancy to 4.2% (+1.7pp YTD). Direction-wise, Chernihiv (M-01), Dnipro (M-04), and Zhytomyr (M-06) highways as well as inner-Kyiv recorded close to 0% vacancy. Occupiers with warehouses in these locations either negotiated discounts during the most challenging months of the pandemic or managed to pay the full rent. Vacancy along the Kharkiv (M-03) highway was registered at 9%, followed by the vacancy between M-05 and M-06 highways, where itstood at 7%. An uptick in vacancies in these locations was in significant part a result of several pre-pandemic-initiated business contractions. Vacancies in the warehouses along the Odesa (M-05) and Warsaw (M-07) highways oscillated at around 3%. Nonetheless, given the overall low volumes of vacant space across the board, the remaining vacancies are barely indicative of relative attractiveness of one highway vs another.

Warehouse rents are particularly sensitive to economic uncertainty, where upwards or downwards changes determine the denomination of rents – In USD or UAH, respectively. As such, despite limited new supply that usually favors the landlords, rent quotations have partially returned back to being denominated in the national currency (Ukrainian hryvnia). By the end of H1 2020, asking rents for ambient warehouses ranged between UAH 133-159/sqm/month ($5.0 - $5.9/ sqm/month) for A class and between UAH 90-110/sqm/month ($3.4-$4.1/sqm/ month) for B class. Actual rents were 5%-7% lower on average. Cold warehouses where more resistant to market fluctuations owing to their scarcity, where asking rents stood at UAH 280-350/sqm/month ($10.5-$13.1/sqm/month) and actual rents ca. UAH 250-300 ($9.4-$11.2) /sqm/month.

Figure 3: Actual Ambient Warehouse Prime Rental Rate, Vacancy and New Supply, 2011-H1 2020



*New supply in 2020 was the result of Falbi warehouse entering speculative market
Source: CBRE Ukraine

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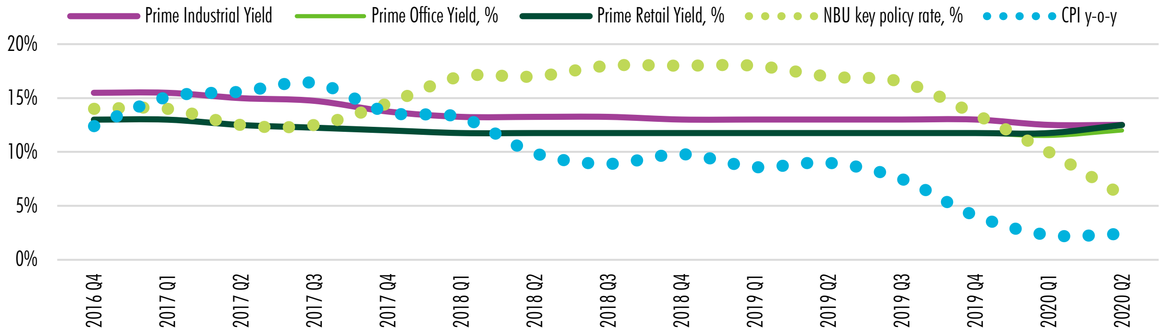
Investment

Key investment transaction finalized in H1 was the purchase of Falbi Pharm Logistics Complex (13,800 sqm) by Dragon Capital Investments Ltd, which made it the 11th logistics real estate property and the first specialized pharmaceutical logistics complex in the portfolio of the investment fund. According to the investor, warehouse properties now account for almost half of their commercial real estate portfolio. However, despite being better positioned than other CRE sectors, warehouse market was not immune to the impact of the pandemic. Investors' risk assessment was affected by the economic turmoil, which led to the softening of industrial prime yields by 0.5pp YTD to equal 12.5%. Should the key policy rate stay roughly the same (ca. 6% an lower), it may eventually contribute to yield strengthening across all CRE segments in the long-term perspective. With e-commerce among key demand drivers for warehouses, the market will be well positioned to rebound quicker than other commercial property sectors, supported by strong fundamentals, continued scarce supply and steady occupier demand.

Figure 4: CRE Prime Yields, CPI, NBU Key Policy Rate



Source: CBRE Ukraine, NBU

Outlook

COVID-19 implies ever larger focus on the expansion of e-commerce and 3PL occupiers – the underlying market drivers of the warehouse sector. The positive effects of this trend are already visible, looking at the on ongoing occupier requirements. In H2 2020, ca. 67,000 sqm of new warehouse facilities are expected for delivery, while more considerable size projects are planned for 2021. Most professional warehouse facilities are likely to start implementing supply chain improvement strategies in the form of increased safety inventories and even accelerated automation efforts in some cases. The need for cross-docking facilities will grow in importance, with a view to optimize storage and reduce handling costs for key occupier groups. The anticipated emerging growth of e-commerce in Kyiv highlights the potential for developers to capture the forthcoming demand and accelerate the construction of new projects, in particular modern in-city facilities. When activity on the capital markets kicks back in, investor focus will initially be directed towards top tier properties; however, these opportunities will remain scarce and/or expensive.

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CLASSIFICATION

Class A:
Newly built ground level modern industrial space that meets A-class standards in terms of warehouse depth and floor height, temperature requirements, sandwich panels, maneuvering areas, number of dock shelter gates and dock levelers etc.

Class B:
Newly built or reconstructed ground or one level industrial space of rectangular shape that meets B-class standards in terms of warehouse depth and floor height, temperature requirements, maneuvering areas, number of dock shelter gates and dock levelers etc.

Class C:
Old stock that due to its configuration, location and overall condition cannot be classed as professional industrial property.

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**

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