Kyiv Office Market

Demand Remains Subdued, But Leasing Momentum Shows Signs of Recovery

Take-up ▼ 21,000 sqm (-50% y-o-y)

Vacancy ▲ 14,4% (+2.0 pp y-o-y)

Prime Rent = $25 sqm/month (0% YTD)

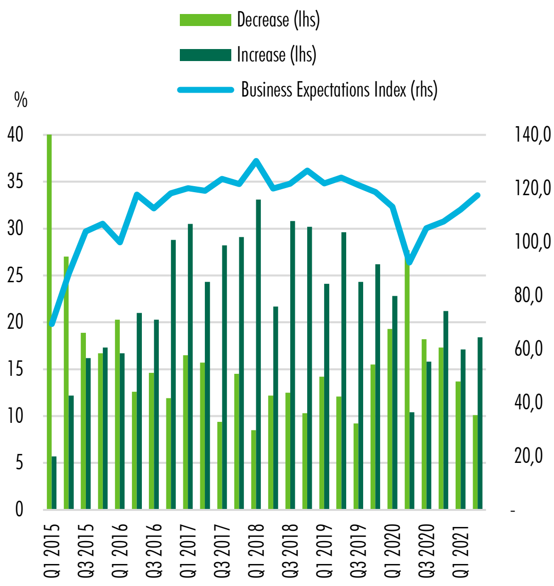
Demand

Gradual economic improvement over the course of H1 2021 paved the way for a gradual recovery in the Kyiv office market. Re-imposition of COVID-induced restrictive measures in early 2021 led to a brief economic slowdown. However, the Ukrainian economy returned to growth starting in April 2021, alongside declining COVID cases and easing of anti-pandemic measures. GDP returned to positive territory in Q2 2021, registering a 6% y-o-y gain after contracting by 2.2% in Q1. In June 2021, increase was also recorded in the Kyiv Business Confidence Index, which rose by 10 p. YTD to 117 p., translating to a broad-based improvement in office market sentiment.

Over the course of H1 2021, the Kyiv office market began to show signs of improvement, albeit remained less active than before the health crisis. Total leasing activity rose by 22% y-o-y to 43,000 sqm in H1 2021; however, the share of relocations and expansions in the total leasing activity was subdued at 49%, with renewals making up the remaining 51%. Take-up therefore added up to a modest 21,000 sqm, down 50% compared to the same period last year. The drop in take-up was mainly due to a decline in larger transactions, as companies chose to optimize their space, as hybrid work model grew in popularity. Tenants were looking for smaller leases, which resulted in the reduction in the average unit size of transactions over 1,000 sqm from 4,000 sqm in 2020 to 2,000 sqm in H1 2021. However, should employees continue to return to offices in the course of H2 2021, average size of new lease can be expected to grow over H2 2021 – H1 2022.

The IT, High Tech & Telecom sector continued to have the largest, albeit shrunk (from 42% down to 19% YTD), share of leasing demand, as most larger companies chose to extend remote or hybrid work model. A notable transaction of this sector was the expansion of Snapchat in UNIT.City with a rather modest lot size of 2,200 sqm. The second largest share of take-up was taken by the Banking and Finance sector at 17%, with the largest transaction represented by Alliance Bank leasing ca. 3,200 sqm in Senator BC. Agriculture and FMCG sectors close up the top-4 largest take-up contributors, with their shares standing at 16% and 13%, respectively.

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



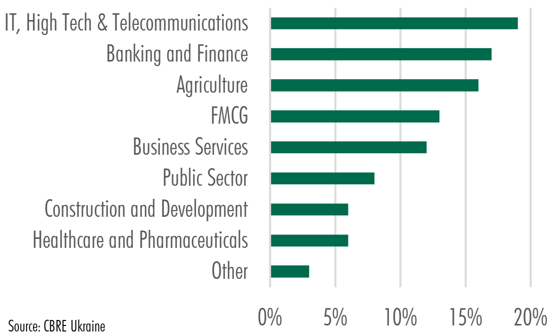
Source: NBU; Lhs – left hand side; Rhs – right hand side

Supply

In H1 2021 a total rather modest volume of 59,300 sqm was delivered to the market, and, as a result, the total Kyiv competitive office stock was nudged modestly up to 2.1 million sqm (+3% YTD). Only three CBD-fringe projects were completed: office scheme at 23 Olenivska St. (26,300 sqm), BC LUWR (Lukianivska Work & Relax) (22,000 sqm), and the office part of retail and complex Retroville (11,000 sqm). The bulk of projected annual supply is expected to enter the market in the course of H2 2021 with a massive volume of nearly 197,000 sqm of office space in 11 projects. Most notable schemes set for completion in H2 2021 include Business Center at 4-6 Korolenkivska St. (80,000 sqm), BC Magnett I (33,000 sqm), BC LAVRSKIY (11,400 sqm), and BC Eleven III (16,500 sqm).

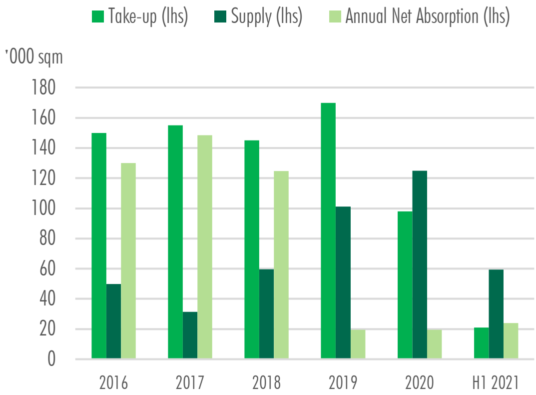
Despite declines in the leasing demand due to pandemic-induced transformation in office use and demand, developers continued with construction of projects already underway. After the completion of announced projects in 2021-2022, however, we expect a decline in new supply due to near absence of new starts in 2020 and 2021. However, the volume of new supply will depend on vacancy rates, leasing demand and pace of occupancy in new projects. As a spike in vacancy has not been observed in 2021, we expect a slowdown in new deliveries to be short-lived, with imminent announcements of new large-scale projects scheduled for completion in 2024-2025.

Figure 2: Total Take-up Structure by Industry, H1 2021 (% share)



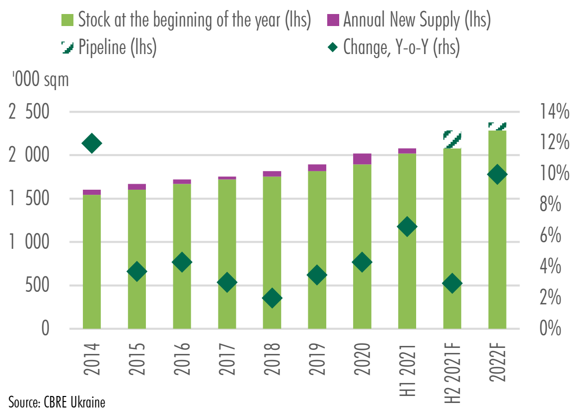
Source: CBRE Ukraine

Figure 3: Kyiv Total Stock and Take-up, 2015-H1 2021



Source: CBRE Ukraine

Figure 4: Kyiv Annual Development and Total Completions Stock



Source: CBRE Ukraine

Table 1: Top-10 Office Lease Transactions in 2021

OCCUPIER	INDUSTRY	PROPERTY	ADDRESS	TRANSACTION TYPE	GLA, SQ M
Huawei	IT, High Tech & Telecommunications	Irva	10/14 Radyshcheva St.	Renewal	5,600
Alliance Bank	Banking and Finance	Senator	32/2 Moskovska St.	Relocation	3,200
A.G.R. Group	Agriculture	Office Scheme	52 Dehtiarivska St.	Relocation	3,000
NDA	Healthcare and Pharmaceuticals	Silver Breeze	1V Pavla Tychyny Ave.	Renewal	2,400
Snapchat	IT, High Tech & Telecommunications	UNIT.City (B10, B11)	3 Dorohozhytska St.	Expansion	2,200
NDA	FMCG	RichPort	1 Petra Sahaidachnoho St.	Relocation	1,900
NDA	Healthcare and Pharmaceuticals	SP Hall	28A Stepana Bandery St.	Contraction	1,900
NDA	FMCG	Office Scheme	19 Druzhby Narodiv Blvd.	Renegotiation	1,900
NDA	Banking and Finance	Podil Plaza	30 Spaska St.	Renewal	1,800
NDA	FMCG	Office Scheme	4 Korolenkivska St.	Renewal	1,800
NDA	Public Sector	M8	8B Moskovska St.	Relocation	1,600
NDA	FMCG	NDA	NDA	Renewal	1 500
NDA	IT, High Tech & Telecommunications	NDA	NDA	Renewal	1 500
BDO Centers	Business Services	Office Scheme	10A Kontraktova St.	Relocation	1,400
NDA	IT, High Tech & Telecommunications	Horizon Park	4V Mykoly Hrinchenka St.	Renewal	1,200

Source: CBRE Ukraine

Table 2: Office Pipeline for 2021-2023

NAME	CLASS (QUALITY & LOCATION)	ADDRESS	GLA, SQM	STATUS
2021				
Office Scheme (K4-6)	AA	4-6 Korolenkivska St.	80,000	U/C
Magnett I	AB	137-139 Velyka Vasylkivska St.	33,000	U/C
UNIT.City (B6)	AB	3 Dorogozhytska St.	14,300	Reconstruction
Eleven III	BB	11 Solomianska St.	16,500	U/C
LAVRSKIY	BB	16 Lavrska St.	11,400	Reconstruction
UNIT.City (B14)	AB	3 Dorogozhytska St.	11,200	Reconstruction
Office Scheme	BC	1V Bazhana St.	11,000	U/C
UNIT. City (B15)	AB	3 Dorogozhytska St.	9100	Reconstruction
Office Scheme	BA	26/14 Spaska St.	9,400	U/C
Office Scheme	BA	9 Bohdana Hmelnytskogo St.	1,800	U/C
2022				
Pyramida	BC	4 Oleksandra Mishugy St.	3,500	Reconstruction
ITT Plaza (Phase I)	AA	16-20, 22 Korolenkivska St.	40,000	U/C
UNIT.City (B4)	AB	3 Dorogozhytska St.	13,300	Reconstruction
Stend II	BC	14 Vasylkivska St.	10,000	Reconstruction
Office Scheme	BC	17E Dniprovska Naberezhna St.	10,000	U/C
Magnett II	AB	137-139 Velyka Vasylkivska St.	10,000	U/C
Andriyivsky	BA	19 Andriyivska St.	9,600	Reconstruction
2023				
UNIT. City (B16)	AB	3 Dorogozhytska St.	12,150	U/C
ITT Plaza (Phase II)	AA	16-20, 22 Korolenkivska St.	40,000	U/C

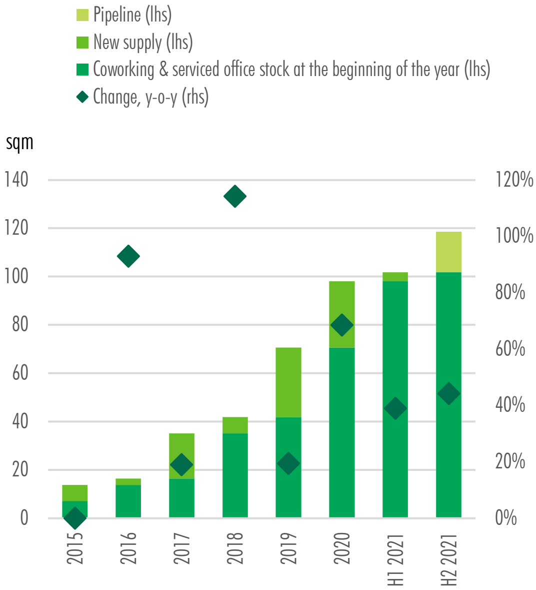
Source: CBRE Ukraine

Flexible/Serviced Office Supply

Ever more occupiers are starting to see the value of flexible offices in their long-term strategies. According to CBRE EMEA Summer 2021 Office Occupier Sentiment Survey, 18% of companies anticipate flex space to account for the majority of their portfolio in two years' time. Serviced offices are anticipated to have an ever more prominent role, as businesses start to make permanent the hybrid work model. In Kyiv, however, over the course of H1 2021 the new supply of flexible space was limited to only 3 coworking & serviced office openings with a meager total of 3,700 sqm. Strengthening demand for flexible office space alongside subdued supply ensured rental rates increased by 10%-20% on average over H1 2021. However, flexible space proposition is expected to grow further by 16,700 sqm during the rest of 2021. Notable expected openings later this year include Creative Quarter at 139 Velyka Vasylivska St. (8,000 sqm), Regus in LUWR BC (2,700 sqm), GNRTR Lounge & Offices (3,000 sqm), and expansion of Creative States Arsenal (3,000 sqm).

Before the pandemic, coworking & serviced office operators were viewed by landlords as usual tenants; however, due to growing demand for flexible space, more and more landlords are starting to regard coworking & serviced office operators as infrastructure partners. In the near term, we expect to see a growing number of partnership agreements between landlords and operators, where both sides will be co-investing and sharing business risks, a model increasingly adopted in developed markets.

Figure 4: Kyiv Annual Development and Total Completions Stock



Source: CBRE Ukraine

Vacancy & Rents

H1 2021 started with a worsening of COVID-19 dynamics and tightening of restrictions in Q1 2021, which slowed down recovery of the Kyiv office market. Average vacancy edged up by 0.4 p.p. YTD to 14.4% by the end of H1 2021, as low volume of new supply was matched by similarly moderate demand. Leasing activity among larger tenants remained subdued, as most such companies have postponed expansion or relocation decisions since the start of the pandemic.

Geographically, the largest increase in vacancy of 13.8 p.p. YTD to 18.2% was registered in CBD-fringe and was primarily driven by the completion of two new, partially leased office schemes totaling 48,300 sqm – office scheme at 23 Olenivska St. (26,300 sqm) and BC LUWR (Lukianivska Work & Relax) (22,000 sqm). With soft demand in H1 and expected surge of supply over the next 12 months, rental recovery in the Kyiv office market is still a far-fetched idea. As of the end of H1 2021, only three out of seven submarkets in Kyiv registered declining vacancy: Podislkyi (-6.4 p.p. YTD), Olimpiiskyi (-2.0 p.p. YTD), and Prime (-0.7 p.p. YTD). However, as the recorded declines in vacancy were marginal and had no significant effect on the overall figure, the average market vacancy remained moderately in the tenant territory.

Slower leasing momentum in the first months of 2021 led to downward adjustments in rental rates over the course of H1 2021. However, the rental decline was less prominent than that witnessed during 2020. Asking rents declined YTD for all grades by about 7-8%, with Grade A and B edging down to **$23-$28/sqm/month** and Grade B to **$13-$23/sqm/month**. Effective prime rent remained stable YTD at **$25/sqm/month**, as leasing activity in new, high quality properties was strong. In fact, 43% of expected supply in H2 2021 is pre-leased. Near null-vacancy is expected in top-quality completions with experienced landlords, such as BC Magnett I (33,000 sqm), UNIT.City B.14 (12,600 sqm), and UNIT.City B.15 (10,600 sqm). Most other schemes will also be partially pre-leased, as tenants are looking for adjustments to the work model through relocations. Vacancy therefore is expected to be relatively evenly distributed across the market, which bodes well for rents staying broadly unchanged over the medium term.

Investment

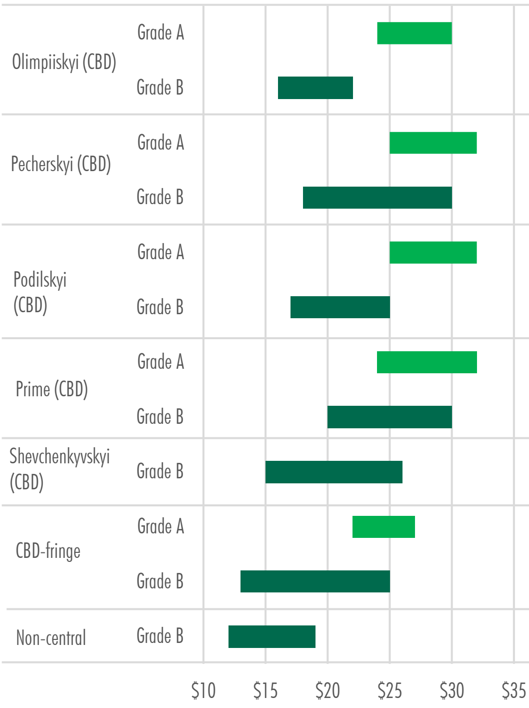
Commercial real estate investment momentum improved in H1 2021, as the economy picked up alongside a declining number of COVID-19 cases. Office sector was seen as still offering comparatively stable sources of income, recorded some demand from investors in H1 2021. Investment activity in the Kyiv office sector registered a modest $15.3 million movement in H1 2021, vs H1 2020 during which no investment transactions were recorded. The investment volume was mainly represented by the acquisition of business center Grand Step (15,000 sqm) by Edelburg Development. At the same time, despite subdued investment activity in the office

Table 3: Vacancy Rates by Kyiv Office Submarkets

Submarket	H1 2021	H1 2020
CBD		
OLIMPIISKYI	4.2%	6.2%
PECHERSKYI	7.7%	7.0%
PODILSKYI	2.0%	8.4%
PRIME	10.2%	10.9%
SHEVCHENKIVSKYI	8.1%	6.8%
CBD-fringe	18.2%	4.4%
Non-central	17.0%	16.0%

Source: CBRE Ukraine

Figure 6: Kyiv Grade A and B Asking Base Rental Range by Submarket as of the end of H1 2021 (USD/sqm/month)



Source: CBRE Ukraine

market in the past 12 months, prime office yields for Kyiv declined by 0.25 pp YTD to 11.75%. This rather surprising trend can in no way be related to the nearly non-existing transaction activity but is rather associated with resilience of the office market in the face of the initial COVID-19 fears.

Outlook

After a period of prolonged corporate deliberations over long-term strategy, leasing activity is expected to rebound, as a sense of predictability is improving alongside hybrid work culture and increasing vaccination rates. A steady momentum of economic recovery is also helping corporate decision-making in a positive way. According to CBRE EMEA Office Occupier Sentiment Survey, conducted in the summer of 2021, 77% of large companies anticipate a long-term adoption of hybrid working practices, while 57% of companies expect office occupancy levels to grow significantly in the near term. In H2 2021, Kyiv's office market is likely to see the return of leasing demand from large international companies, subject to COVID incidence rate being kept under control.

Accelerated adoption of the Work-From-Anywhere or remote work model has been among key trends in the office market. Potential cost savings from a reduced office footprint have led many tenants to question the value of traditional office space as we used to know it. However, far from abandoning office space as such, as Twitter conceived of doing at the onset of COVID, office space evolved from a product to a service, with a Phoenix-like renaissance on the cards. The functions of office have been redefined from a chair + a desk to an interactive platform, focused on flexibility, user experience, and collaborative spaces. New user preferences are thus shifting developer focus with revolution-like pace towards agility, communal space, and overall finger-snap suitability to immediate user demands. And with employees more than ever aware of the work-life balance, home and office are ever more blending and becoming extensions of each other rather than antagonists that they used to be.

We therefore anticipate a gradual strengthening of office fundamentals to reinforce a rebounding investor interest over H2 2021. The attractiveness of local yields will also be a factor for investors, as relative market risks for small to medium size investments warrant a much lesser spread with Central European markets. Thus, with the office market being ever more shaped by medium-size, high quality schemes catering to the private investor, we also expect to see a growing number of investors and moderate yield compression over medium term. Long-term yield compression, however, depends on macro steps towards establishing a rule-of-law economy and level playing field that Ukraine is steadily, albeit timidly, moving towards.

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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.**