



Ukraine Real Estate Review

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SUMMARY

World financial crisis has reached Ukraine, which has already been demonstrated by FDI growth slowdown. Quite expectedly, it has touched upon real estate sector, where the number of deals decreased sharply and construction works statistics show a declining trend. While potential investors are pondering over the wisdom of entering the market, many of those already in stop their aggressive development plans for Ukraine, referring to inflationary, political, and financial risks. The Caucasus war might further aggravate the situation scarring off potential investors not only to Russia and Georgia, but the whole CIS region, including Ukraine.

Financial crisis will undoubtedly postpone commissioning of many development projects under construction and might cause cancelation or significant revision of the projects currently being planned.

Local developers are in desperate search for funds. Many of them are forced to sell part of their businesses. One of the examples is the anticipated sale by XXI Century of its logistic subdivision, evaluated at approx \$185 million.

In the second half of 2008, the number of deals might increase, but these will mainly be 'forced' sales initiated by local developers, which lack resources for ongoing projects.

The most affected by the crisis is residential sector, where shrinking of mortgage lending has cut off traditional sources of funds for developers. To stir up demand residential developers resort to various marketing instruments, especially discounts. Apparently, developers are not yet ready for substantial price cuts; however, soon they will be forced to bring prices down.

POSTPONED CONSTRUCTION

Ukrainian office market experiences continuous rental price rises due to substantial office space deficit. Kyiv alone would absorb up to 2 mln sq m of office space. Vacancy rates in the capital are extremely low: 1-3%. In such business centers as Leonardo and Iceberg vacant office space is very scarce

As mentioned in previous issues of the *Review*, market might reach its saturation point no earlier than 2012-2013. However, current liquidity problems experienced by developers will most likely postpone this projected saturation to a later date.

As of today, around 6 mln sq m of office projects have been announced to be put into commission by 2013. However, development projects in Ukraine rarely are finished on time. Moreover, taking into account that development companies due to current liquidity problems are forced to suspend construction works on many projects, the years 2012-2013 do not sound realistic anymore. Yet, even if 30-40% of the projected office space bulk will be put into commission on time, this will take the market close to saturation.

But until then, prices will keep rising. Today the average rental price in the office centers of class A equals \$90/sq m/month, class B - \$55-60/sq m/month. By the end of 2008 prices are expected to grow by another 10-15%.

RETAIL-DEVELOPMENT SYNERGY

Lately, more often we can observe Ukrainian retailers start development projects. Development is attractive not only by its higher profitability compared to retail, it lets them diversify their business and, what is the most important, secure trade space availability for their supermarkets.

As it was mentioned in previous issues of the *Review*, Ukrainian retail experiences a huge deficit of vacant trade space. Vacancy rates do not exceed 3%. No wonder, in such situation rental prices constantly grow. That's, probably, the main reason which makes retailers develop trade centers for their own use. At the same time, it allows to diversify business and earn money leasing trade space to other operators.

Retail-development synergy appears to be most popular among food retailers. Table below lists major retailers-developers of Ukraine and their development projects in operation. All of them have plans for further expansion in real estate development. One of them, Amstor, has even decided to sell its retail business and focus on commercial property development.

Retailers-developers in Ukraine

Retail company	Retail chains	Trade centers developed
Rainford	Rainford	“Materik” and “Materik 2”
Auchan-Furshet	Auchan, Furshet	“Auchan”
Karavan	Karavan	Two trade centers “Karavan”
VK Development	Velyka Kyshenya	Over 100 ths sq m of own trade space leased to other market operators
Amstor	Amstor	240 ths sq m of own trade space in 10 Ukrainian cities
Krai Property	Krai, Kraina	Two trade centers “Magelan” and one “Krai”

Source: market operators, CASE Ukraine estimates

However, not only food retail is engaged in development. For example, one of the leading Ukrainian DIY retailers, Epicenter, also develops trade centers for their own DIY hypermarkets.

Retail-development trend, definitely, has a future, even under current circumstances of liquidity crisis. Retailers have more opportunities to find necessary funds; they can reinvest their retail business profits into development projects.

XXI CENTURY SELLING ITS WAREHOUSE SUBDIVISION

Faced with liquidity crisis Ukrainian developers are in desperate search for funds. Many of them are forced to sell part of their businesses. One of the examples is the anticipated sale by the local developer XXI Century of its logistic subdivision.

Mid-august one of the leading Ukrainian developers, XXI Century, signed an agreement with the intention to sell its logistic business to British company Parkridge Holdings. XXI Century warehouse subdivision value was estimated at about \$185 million. However, taking into account current liquidity crisis, which brought around price reductions, the actual deal value might be lower.

Logistic business is new to XXI century, started just last year. Currently, the company's logistic profile includes seven warehouse projects at different stages of development. Three of them are in Kyiv region, and the other four in Odessa, Dnipropetrovsk, Simferopol, and Kharkiv regions.

XXI Century warehouse projects

Project location	Region	Warehouse space, sq m
Vasil'kov	Kyiv	154,000
Vyshgorod	Kyiv	109,000
30 km from Kyiv, Kyiv-Zhytomir highway	Kyiv	116,000
6 km from Odessa, Kyiv-Odessa highway	Odessa	94,800
Near Dnipropetrovsk	Dnipropetrovsk	223,300
11 km from Simferopol, Kharkiv-Simferopol highway	Crimea	86,000
Near Kharkiv	Kharkiv	115,000

Source: market operators, CASE Ukraine estimates

XXI Century is selling its logistic business not only for the reason of its relative immaturity, but also because of its lower profitability compared, for example, to their main development direction – shopping centers. This idea is supported by the developer's announced plans on further development of its shopping center chain "Kvadrat" in Kyiv, Kharkiv, Donetsk, Simferopol, Lviv, Poltava, Sumy, and Cherkasy.

BUY TWO, GET ONE FREE

The residential market has suffered the most from the financial crisis. Residential developers lost their main source of financing after the NBU has toughened control over mortgage lending. In order to somehow attract those who can pay for housing with their own resources but are still hesitating, developers use various marketing tools including discounts.

In fact, discounts are the most popular tool. They mostly range from 3 to 10%, depending on apartment location, size, number of rooms, etc. Some developers, for example Konsol went even further and offered 20% discounts for multi-room apartments in one of their Kyiv projects. Marketing instruments, however, did not seem to be very effective. Only finished or almost finished projects, where discounts were substantial, demonstrated sales growth.

Numerous apartment promotions will be around for a while; however, developers sooner or later will be forced to start cutting prices. Those potential buyers, which can afford 100% payments at once without mortgage loan, are behaving highly selectively, in majority of cases, waiting for the price fall. Thus, by the end of 2008 discounts might be still kept, but at the same time prices are expected to fall by 20-25%.

HOTEL ALTERNATIVES FOR EURO 2012

For the Euro 2012 final up to 300 thousand football fans are expected to visit Kyiv. Municipal government assures that enough hotels will be built by that time in the capital. However, investors, which are expected to invest into these hospitality projects, have their own point of view on the issue.

Hotel developers, first of all, consider long-term perspectives for each hospitality project. Unfortunately, short-term events, such as Euro 2012, cannot cover all the expenses. Payback period for investments in hotel development is around 7-10 years. Therefore, investors are most interested in 5- and 4-star hotel projects, which are considered as most promising in the capital of Ukraine.

The economy segment (3-, 2-star hotels and hostels) appears to be less attractive for investors. The lack of economy segment hotels will most likely be compensated by the supply of apartments market. The short-term apartments market in Kyiv is represented basically by two main formats: professional apart-hotels (apartments under one roof, owned and professionally managed by one company) and separate apartments (let on lease by the owner or real estate agency). The apart-hotels in Kyiv are not numerous either, two operators are present on the market: Guest House Sherborne and Senator Apartments. The market of separate short-term apartments of different size and comfort level is estimated at about 10-15 thousand apartments.

Nevertheless, the existent amount of economy segment housing will hardly be enough to host all 2012 visitors. Kyiv municipality has got to find some adequate solutions and provide enough places for the football fans.