



Ukraine Real Estate Review

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SUMMARY

Central parts of Ukrainian cities, especially Kyiv CBD, are running out of available land plots suitable for office centers. Therefore, office market developers are either buying centrally located old buildings with the purpose of reconstruction or looking for new territories outside of CBD areas for business parks development. Noteworthy, the majority of projected business parks will be located within the city boundaries. This Ukrainian peculiarity is dictated by much needed proximity to public transport infrastructure, since many office workers for various reasons still use public transportation.

Ukraine's retail market keeps attracting foreign giants. World-known retail chains are not getting scared off by local hardships mainly associated with land plots issues. International retailers found a solution – they enter the market in partnerships with domestic players.

Swift retail development gives rise to increase in warehouse construction growth. Demand - already exceeding the current supply by 2.5-3 times – will further grow. This tendency is evident to developers. They are becoming more active in warehouse segment, where construction craze have not been noticed yet. Supply of modern warehouse space has been increasing lately by 3-3.5 times annually.

Ukraine's residential market, with Kyiv in forefront, is showing first signs of long-expected housing fall. Increasing stock of unsold housing, suspension of construction works, and sharp decrease in residential sales – all signal about approaching housing drop.

EURO 2012 is a great opportunity for Ukraine to shift current development boom from office and trade real estate to hotel market, which definitely is underdeveloped. However, political controversies are preventing the authorities to consolidate for prolific work on infrastructure preparation.

OFFICES DECENTRALIZATION

Central parts of Ukrainian cities, especially Kyiv CBD, are running out of available land plots suitable for office centers. Therefore, office market developers are either buying centrally located old buildings with the purpose of reconstruction or looking for new territories outside of CBD areas for business parks development. Noteworthy, the majority of projected business parks will be located within the city boundaries. This Ukrainian peculiarity is dictated by much needed proximity to public transport infrastructure, since many office workers for various reasons still use public transportation.

In a long-term perspective, business parks undoubtedly, will take the lead. Reconstructing old buildings is costly and sometimes turns to be unprofitable. Moreover, large-scale office projects need more space than majority of old building can offer.

The pioneer business park in Ukraine was constructed in Kharkiv – Telesens Ventures – located on the city’s outskirts. The first business park in Kyiv – Forum Park Plaza - was put into commission in 2005 (1st stage). Currently Ukrainian market has over ten business park construction projects. Given, continuously growing demand for quality office space and lack of available space in CBDs, more and more of such projects will appear.

Kyiv business parks (currently being projected/constructed)

Business Park	Office space, sq m	Developer
World Trade Center Kyiv	150,000	Kyiv Donbas Development
Business park (on left Dnieper quay)	133,000	Kyiv Invest Group
Kyiv Airport City	160,000	DEOL Partners
Alacor Business Park City	38,000	Alacor
Zhulyany Business Park	30,000	n/a

Source: market operators, CASE Ukraine estimates

In the regions the leaders of business parks development are Kharkiv and Odessa. End July, Israeli developer Europort announced starting a business park project Airport City near Odessa international airport.

For reference only - In the 1st half-year 2008 in Kyiv were put into commission about 90,000 sq m of office space class A and B+. However, this is far not enough to satisfy the existent demand, which is constantly growing thanks to increasing business activity. Till the end of the year approx the same amount of office space is to be put into operation.

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Thus, the world's second largest retail chain Carrefour is planning to come to Ukraine in partnership with local hypermarket chain "Karavan". This will be the forth large foreign retailer, entering the market with the help of local partners. Successful precedents are French "Auchan", Serbian "Delta Maxi Group", and Russian "Mosmart" – all working in joint ventures with local retailers. Entering Ukraine's market self-reliantly poses serious risks for the chain's future development – examples of stagnating "Billa" and recently forced out Russian "Paterson" speak for themselves.

Foreign DIY retailers choose the same strategy – German "OBI" plans to build DIY hypermarkets in Ukraine in partnership with local billionaire, Gennadiy Bogoliubov. "OBI"'s competitor German "Praktiker", which was the first foreign DIY retailer to enter Ukraine (2007), also seeks cooperation with a local partner. "Auchan" will bring to Ukraine its DIY chain "Leroy Merlin" – most likely again in joint venture with domestic player. This is not to mention other perspective DIY entrants, such as Israeli "Home Centers" and German "Bauhaus".

Retail market operators are reorienting to active development in the regional cities, where retail market is still far from its saturation point. Thus, eight out of ten trade centers to be put into commission in 2008-2010 are located in the regions.

Trade centers to be put into commission in 2008-2010

Trade center	City	GLA, sq m	Developer
Forum Kharkiv	Kharkiv	90,000	Multi Development
Riviera Shopping City	Odessa	85,000	Agro Real Estate Opportunities Fund
Karavan	Zaporizhye	85,000	Karavan Group
Dafi Retail Park	Kharkiv	80,000	Dafi
King Cross Leopoldis	Lviv	70,000	King Cross Group/ Comfort Invest
Magellan	Kharkiv	65,000	Kray Properties
Ippodrom	Odessa	63,000	Acteum Group
Petrovka Mall	Kyiv	57,000	Knizhnyi Rynok
Sky Mall	Kyiv	45,000	Panorama Group
Admiral	Simferopol	43,000	Panorama Group

Source: market operators, CASE Ukraine estimates

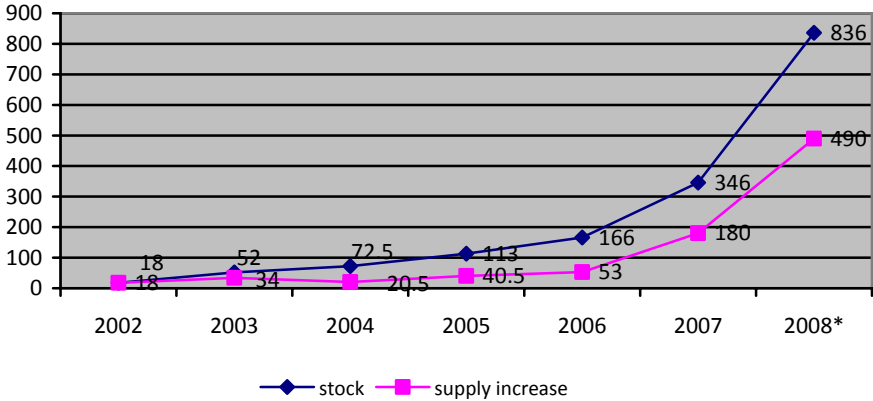
The latest tendency of the market is enlargement of trade centers in Kyiv and regional cities from 20-30 ths. sq m to 50-150 ths. sq m of total space. As a consequence, trade centers are gradually moving from central locations to the cities' outskirts.

Another tendency is the increasing role of entertainment zone in trade centers. Newly launched and soon appearing trade/entertainment centers often have up to 50% of their space occupied by various amusements. This tendency will very likely develop in Ukraine into something that might be called ‘retail-resort’, when shopping time is conveniently combined with leisure time.

WAREHOUSE ACTIVATION

Swift retail development gives rise to increase in warehouse construction growth. Demand - already exceeding the current supply by 2.5-3 times – will further grow. This tendency is evident to developers. They are becoming more active in warehouse segment, where construction craze have not been noticed yet. Supply of modern warehouse space has been increasing lately by 3-3.5 times annually.

Modern warehouse stock in Kyiv region, ths sq m



Source: market operators, CASE Ukraine estimates

The main difficulty for warehouse developers, just as in retail, remains land issue. However, positive tendencies here are already observed. In Kyiv region, for example, local authorities are getting more cooperative in land plots allotment for warehouse construction.

The majority of Kyiv region warehouses in the pipeline are located along highway Kyiv-Zhytomir (M-06). Generally, the right (western) Dnieper river bank is more attractive for warehouse development, since the majority of goods arriving to the capital is coming from Europe.

Warehouse construction boom is only starting in the Kyiv oblast, but it will soon be exported also to the regions.

RESIDENTIAL MARKET FACING STAGNATION

Ukraine's residential market, with Kyiv in forefront, is showing first signs of long-expected housing fall. Increasing stock of unsold housing, suspension of construction works, and sharp decrease in residential sales – all signal about approaching housing drop.

The crisis in credit markets has affected mortgage lending, which has significantly shrunk. Potential buyers, in expectation of price decrease, take a wait-and-see attitude. Demand is falling; however, prices are still kept the same. A few major residential developers would rather shrink construction volumes, than let prices go down. For the 2nd quarter of 2008, real estate agencies report stable prices or slight price increases mainly in central parts of Ukrainian cities (where apartments are usually bought with purposes of further rent or for office premises), while price decreases in less attractive districts.

Ukrainian residential secondary market rating, 2Q2008

Rating	City	Weighted average price, \$/sq m	Price change, % to 1Q2008
1	Kyiv	3,367	+4.6
2	Odesa	2,010	+3.7
3	Donetsk	1,979	+7.4
5(+1)	Sevastopol	1,955	+9.5
5(+1)	Lviv	1,943	+11.0

Source: Ukrainian realtors association

In mid-July Kyivmiskbud – the leading residential developer – declared about suspension of construction works on over fifteen projects. This was the first official 'message' that there is something cooking in the sector. Construction companies are suspending projects, first of all, because of the lack of financing. Since NBU toughened control over mortgage lending, construction companies lost not only their traditional sources of financing – advance payments from apartment buyers, but also, in some cases, bank loans. Banks have raised their rates and now tend to finance only large well-established developers. Thus, small companies might be forced to leave the market in the near future.

Meanwhile, rental market, panic-stricken after the hryvna revaluation, experienced rates increases. Landlords, in fear of further dollar weakening, moved from traditional US dollar denominated settlements to euro or hryvna, significantly raising rental prices. The most affected tends to be daily rent segment, which is very fast-reacting.

HOTEL INFRASTRUCTURE - PREPARING FOR EURO 2012

EURO 2012 is a great opportunity for Ukraine to shift current development boom from office and trade real estate to hotel market, which definitely is underdeveloped. However, political controversies are preventing the authorities to consolidate for prolific work on infrastructure preparation.

In view of quickly approaching EURO 2012, it would be rational to create legal framework prioritizing development of the most essential objects needed for hosting the Euro Cup. In fact, such piece of legislature is currently being prepared, but it is hard to predict how soon it might be passed. For sure, among first priority areas should be hotel infrastructure.

The Government EURO 2012 goal-oriented program, approved on February 22, 2008 sets specific funds for solving the hotel problem. About 21% of funds stipulated for EURO 2012 preparation, are directed to hotel infrastructure development. This amounts to approx. USD 5.5 billion, out of which only 2.3% will come from the State Budget, the rest – from private investors.

The total of 231 hotels are planned to be built: 25 – five-star hotels, 82 – four-star hotels, 124 – three-star hotels. Moreover, 96 operating hotels are to be reconstructed and 51 operating hotels – reequipped.