Kyiv Retail

H1 2011

Quick Stats

	Change from H2 '10	Change from H1 '10
New supply	↓	→
Rents	↑	↑
Vacancy	↓	↓

Hot Topics

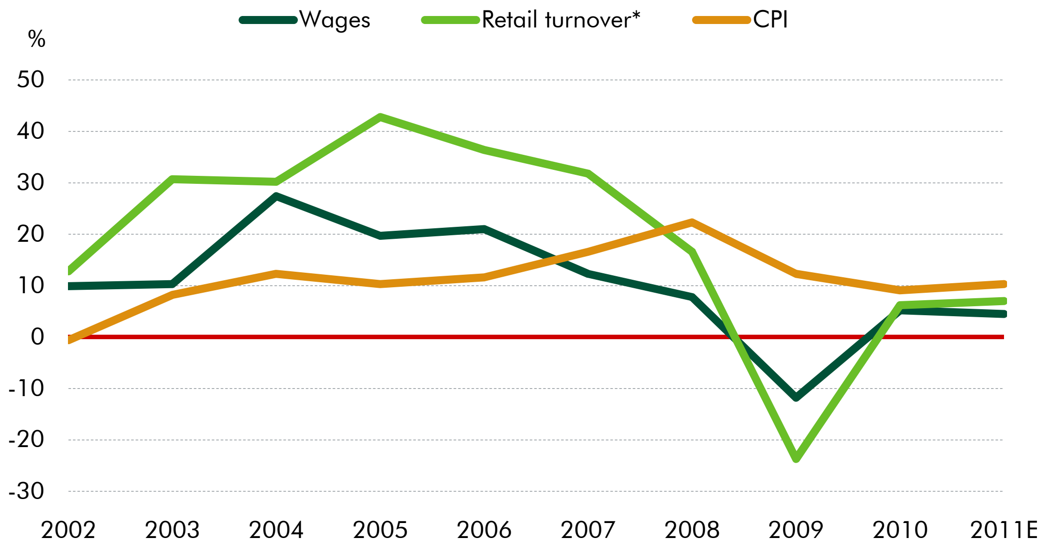
- Consumer demand is getting stronger: in six months retail sales grew 16.7% y-o-y, backed by rising wages and improving consumer credit market
- Developers' activity is picking up: even though no new retail schemes were delivered in H1 2011, annual completions are expected to be 50% higher compared to 2010, as all deliveries take place in the second half of the year
- Prime rents are rising: ongoing shortage of quality supply continued to put upward pressure on prime rents (+6% from H2 2010) with secondary rents starting to inch up as well

FUNDAMENTALS

Ukraine's economy started the year on a solid footing, growing by 5.3% in Q1 2011 on the back of improving domestic consumption even as external demand remained weak. However, in Q2 2011 the main components of GDP were showing patchy dynamics, resulting in uncertain projections for annual GDP growth, which are currently spanning from 4.0% to 5.5%[1]. At the same time the rate of inflation reached 5.9% (+2.6pp y-o-y) due to rising food and gasoline prices. By the end of the year prices are expected to slow down slightly but to remain in the range of 9.0% -10.5%.

Following the unexpectedly strong performance in 2010, retail sector is displaying even better results in 2011. Over first six months of the year retail sales growth in Kyiv accelerated to an impressive rate of 16.7% compared with a mere 3.6% in H1 2010. Although such a major improvement can be attributed to base effects, consumer demand clearly continues to strengthen, helped, in large part, by rising incomes, which jumped 6.5% y-o-y in five months to the end of May.

Kyiv Wages and Retail Turnover Growth



* - includes organized retail sales only
Source: Kyiv Statistics Office
E - estimate by Kyiv City State Administration

Despite inflationary pressures witnessed in the first half of the year, retail turnover growth in real terms outpaced income growth, indicating that households are currently willing to spend more. Indeed, after declining in Q1 2011, nationwide consumer sentiment has been improving for three consecutive months now, posting 14.3 points rise. That said, consumer confidence still remains outside of positive territory. Kyiv citizens, however, were more optimistic in their outlook compared to the rest of the country.

[1] - Latest forecasts provided by the following organizations: EBRD, Oxford Economics, Cabinet of Ministries of Ukraine, Ministry of Economic Development and Trade of Ukraine, Troika Dialog, Goldman Sachs, National Bank of Ukraine

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Finally, improving credit market conditions contributed a great deal towards stronger growth of retail sales. Over H1 2011 short and mid-term loans have become more accessible, spurring sales of durable goods, which is especially evident in Consumer Electronics sector. In five months to the end of May, the stock of consumer loans in national currency increased by 8%, whereas in the same period last year it declined by 1.2%.

DEMAND

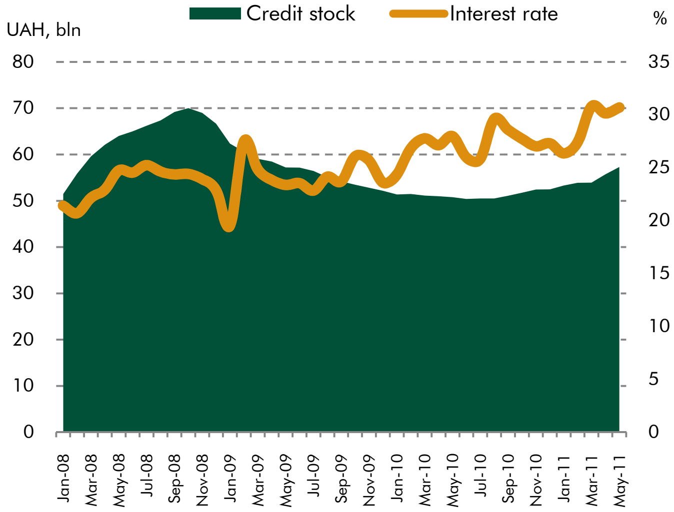
Steady sales growth encouraged retailers – especially, those with healthier balance sheets – to resume their strategic expansion plans, albeit slowly and less aggressively than before 2008. Food and Consumer Electronics operators were growing most rapidly in H1 2011. A major deal witnessed over the reported period involved Real (Metro Group), a German food giant, pre-committing to almost 12,000 sq m in Ocean Plaza shopping center, scheduled for delivery in H2 2012. This will be retailer's second store in Ukraine and the first one in Kyiv.

Retailer's expansion is still constrained by the shortage of quality space. Nevertheless, several new retailers, including international ones, managed to enter the market in H1 2011. In early June, GAP, American clothing and accessories brand opened a 1,000 sq m flagship store on Khreschatik Street and announced plans to launch two more shops in Kyiv and Dnipropetrovsk by the end of the year. Among other developments, L'Etoile, Russia's largest Health & Beauty chain entered Ukrainian market by acquiring two local chains: Brocard and Bonjour. Also notable was the opening of the first stores of New Yorker, a German casual retailer, and that of Oysho, an underwear brand of Spanish Inditex Group – both now operate in Sky Mall shopping center. Furthermore, some retailers that entered the market in 2010 (River Island, New Look) expanded their chains in H1 2011 adding new stores in Globus and Karavan shopping centers in Kyiv.

SUPPLY

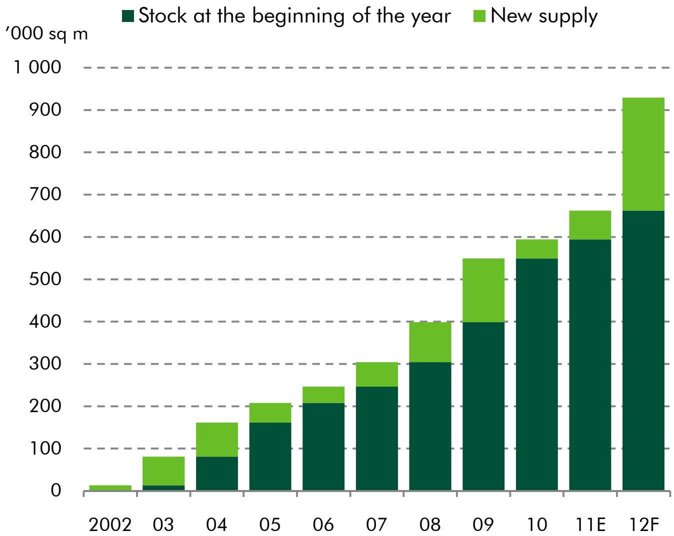
With no quality retail schemes delivered in H1 2011 Kyiv shopping center stock was unchanged at just under 600,000 sq m of professional retail space[2]. At the same time, the level of construction activity on the market increased markedly. The planning and the actual construction of new retail space are on the rise, fuelled by stronger demand, easier credit and more accessible debt financing. However, because of the lagged impact of economic events on development market, it would take many months before completions start demonstrating some noticeable improvements.

Stock of Consumer Credit* and Interest Rate in Ukraine



* - for consumer loans issued in UAH, monthly average weighted rate per annum
Source: National Bank of Ukraine

Kyiv Shopping Center Stock



E – estimate
F – forecast
Source: CB Richard Ellis

Seven months ago we forecasted 2011 annual additions to the stock to reach 100,000 sq m in three shopping centers. However, only two schemes are now expected to enter the market in 2011, given that the delivery of Continental shopping center has been delayed until 2012. Our revised forecast, therefore, is for 68,000 sq m of new space in 2011, which still represents a respectable 50% increase on 2010. A major completion in H2 2011 is a theme-oriented Phase II of Dream Town shopping center (GLA - 45,000 sq m) expected in mid July.

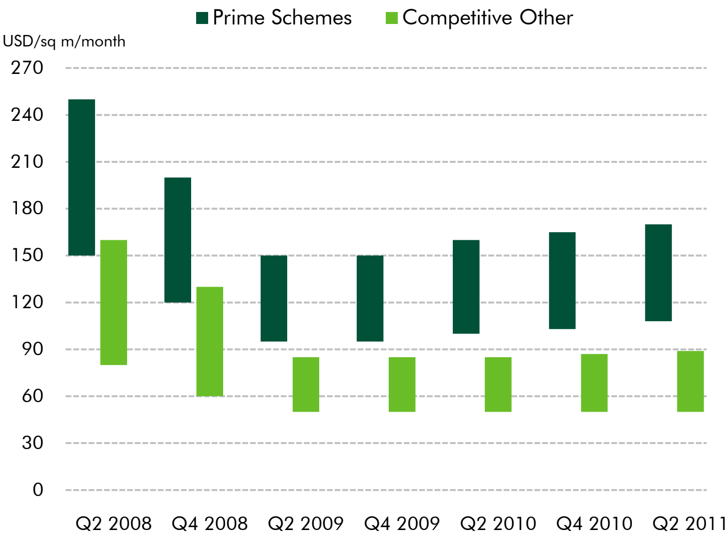
[2] Retail schemes featuring a hypermarket and a small retail gallery that were previously left out of the stock, have been included into calculations, starting from June 2011. Annual development completion figures were adjusted accordingly.

Key Retail Schemes in 2011-2012 in Kyiv

NAME	LOCATION	DEVELOPER	GLA, sq m	COMPLETION*
Dream Town (Phase II)	Residential district	Vita-Veritas	45,000	H2 2011
Promenada Park (Phase II)	Out of town	Promenada Center	23,000	H2 2011
Alacor City	Transitional district	Alacor	28,000	H1 2012
Continental	Central district	Tri-O	38,000	H1 2012
Marmelad	Transitional district	VKF Mava	39,000	H1 2012
Aquapark	Residential district	Prestige	49,000	H2 2012
Ocean Plaza (Phase I)	Transitional district	K.A.N. Development	72,000	H2 2012
RayON	Residential district	Arricano Group	23,000	H2 2012
Silver Breeze	Residential district	Svitland	21,000	H2 2012

* - according to developer's announcements
Source: CB Richard Ellis

Base Rents in Kyiv as of H1 2011



Source: CB Richard Ellis

Turnover Rents by Format as of H1 2011

	Food hypermarkets/ supermarkets	Mini Anchors	Fashion Retailers	Entertainment
% of turnover paid as rent	2-4%	>8%	10-15%	8-12%

Source: CB Richard Ellis

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Looking into the future, it is important to note that H1 2011 was marked by several prominent development starts, such as RayON, Silver Breeze and shopping center on Grigorenka Street. No less important is the fact that all of the schemes are located on the East (Left) bank, reflecting increased interest towards developments there. Densely populated residential districts and the obvious undersupply of quality retail space in this part of the city, make it very attractive for developers and retailers alike. As a result, nearly 35% of premises pipelined for 2012 are located on Kyiv's East bank.

Despite numerous announcements made last year about the imminent plans to develop an outlet center and a retail park, no construction starts were observed in H1 2011. Furthermore, the realization timeline for the majority of projects is currently unclear. The only exception is Kiev E-95 Outlet Center, developed by Evo Land Development, which is expected to start the construction on the scheme already in summer 2011.

VACANCY AND RENTS

Strong occupiers' demand in prime locations ensured that vacancy there remained close to null. At the same time, the combination of limited availability in the most successful schemes and increasing demand forced retailers to consider other locations. Secondary vacancy, therefore, declined to 2-4% over H1 2011, while availability rate in prime shopping centers stayed at 0-2%.

Prime rents in Kyiv went up by 6% in H1 2011 thanks to consistently strong occupiers demand, coupled with ongoing and acute deficit of available prime space. Thus, by July 2011 rents in most successful shopping centers varied between $100 and $170/sq m/month (triple net) for a typical gallery unit of 100-200 sq m. Rents in secondary locations, however, remained mostly flat at $50-80/sq m/month for typical gallery units with some minor increases in selected schemes with good locations.

Turnover rent, which requires a tenant to pay minimal fixed rent as well as a certain, pre-determined percentage share of retail turnover, has been a common market practice in the last two years. As an alternative, the landlord sometimes decides which payments to receive - rent or percentage of a turnover - whichever is higher. However, pure turnover rent is a rare case. The percentage differs significantly depending on the retailer format.

REGIONS

Consumer demand throughout Ukraine continued to expand over H1 2011. According to the State Statistics Committee, national real wages rose 9.6% over the first five month of the year while retail turnover grew 15% in the year to June.

Lured by reviving demand, many retailers started to express extra interest in regional markets in H1 2011. Food retailers (ATB, Fozzy Group, Novus, EKO) and Consumer Electronics operators (Comfy, Foxtrot, Foxmart, Eldorado, Moyo) were the most active players outside the capital city and continued to grow their chains quite extensively. Conversely, Fashion retailers and DIY operators adopted a wait-and-see approach, putting on hold any new developments, which meant that their store networks in the regions remained virtually unchanged over H1 2011. Epicenter, a local DIY giant, opened its 28th hypermarket in Kirovograd in April, which was the only delivery in the segment over the reported period. However, fashion retailers do look at the projects under active construction in the regions, and what is particularly remarkable is that their interest is no longer focused exclusively on cities with population of over 1 million, but also extends to smaller Tier 2 and Tier 3 towns. It should be noted that retailers remain very selective and their expectations of a potential shopping center are very high – excellent location, professional concept, credible developer are only the most obvious.

Construction works in the regions are equally on the recovery path. In H1 2011 peripheral property markets witnessed several development completions, including Phase II of City Mall shopping center in Zaporizhia (GLA – 9,000 sq m), AeroMall shopping center in Boryspil (GLA – 15,000 sq m) and Ukraina retail scheme in Mariupol (GLA – 13,000 sq m). Construction works on several large projects that were put on hold during the crisis has also been resumed lately – namely, in the case of two shopping centers in Kharkiv: Magelan and Frantsuzkyi Bulvar. Besides it is not only large regional centers that are seeing an increase in developers' activity, but also smaller cities such as Kherson, Vinnytsia, Cherkasy, etc.

One of the main trends of H1 2011 was redevelopment of some existing schemes with inadequate concept into a more efficient shopping center. Since most retailers in the regions are now targeting only a limited number of top properties with best marketing and architectural concept as well as prime location, developers are trying to adjust accordingly.

Key Retail Schemes in 2011-2012 in Ukraine

NAME	CITY	DEVELOPER	GLA, sq m	COMPLETION*
Donetsk City (Phase II)	Donetsk	Domus	25,000	2011
Fabrika (Phases I,II)	Kherson	Bud House Group	49,000	2011-2012
Magelan (Phases I,II)	Kharkiv	Kray Property	63,000	2011-2012
Amstor	Odesa	Amstor	58,000	2012
City Center (Phase I)	Odesa	Local developer	30,000	2012
Donskoy City Park (Phase II)	Donetsk	Immochan	26,000	2012
Frantsuzkiy Bulvar (Phase II)	Kharkiv	Aksioma	34,000	2012
Lubava	Cherkasy	Bud House Group	18,000	2012
Panorama	Odesa	Redstone	17,000**	2012

* - according to developers' announcements
** - total for Phases I and II after the commissioning
Source: CB Richard Ellis

Prime rents in the regions remained generally flat in H1 2011 at $30-60/sq m/month (triple net) for a typical mall section. However, there are signs of rents moving upward slightly in the primest schemes. Looking ahead the number of schemes demonstrating rental growth in regions is expected to moderately increase by the end of 2011, especially in large cities with limited new quality supply.

YIELDS

There were no investment transactions in the retail sector in H1 2011. Positive economic signs, however, did bring about a decline in prime yields, which compressed by 1pp to 13% in Q1 2011, but remained broadly stable in Q2 2011. Provided the economy sustains its present growth rate, yields should fall slightly further before the year end.

Historically, retail was the second (after offices) most popular sector among local and international investors. However, due to a more rapid recovery of consumer market, retail properties moved to top position.

While there were no pure investment transactions, the market still witnessed a few development deals as well as acquisitions of land intended for retail use. Most notable transactions over the reported period include: the purchase of Kyiv Central Department Store (TSUM) by Esta Holding, a local development company, and the acquisition of Gorkiy Park retail and office project by SCC, a French developer.

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OUTLOOK

In H1 2011, Ukrainian retail sector continued to demonstrate solid growth patterns, with accelerating retail sales and rising construction works. Should retail economics remains strong in the forthcoming six months, international and domestic retailers can surely be expected to step up their activity in the short term.

By the end of 2011, 68,000 sq m of retail space are projected to enter Kyiv market with Dream Town shopping center (Phase II) being a major development. Provided the scheme offers space only for entertainment and home appliances, the speculative new supply in 2011 is likely to amount to only 23,000 sq m, which, in turn, will not be enough to accommodate current expansion plans of most retailers. If guided solely by developers' announcements, the completion levels in 2012 should reach an all time record of 270,000 sq m. However, we believe that the probability of the realization of this entire volume is rather low given how common the practice of commission delays is in Ukraine.

Upward pressure on prime rents is likely to remain throughout 2011 mainly due to limited availability of quality premises and high demand from retailers in the top tier of the market. With very little new additions in 2011 and stronger demand, average rentals on the market are projected to continue growing in the mid-term with prime rents rising further by some 5-10% by the end of the year. We expect secondary rents to display some upward movement of ca. 3-5% in 2011 mainly in schemes with good locations and professional concept.

Since a more robust occupier demand in the regions has revived construction works there, we expect development completions to rise in H2 2011 and accelerate further in 2012. Despite increased activity from retailers, by the end of 2011 we see only moderate rental growth emerging in just a few selected schemes with close to zero vacancy and quality tenant mix.

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