Ukraine Real Estate Review

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SUMMARY

Ukraine's real estate market is currently defined by a severe deficit of quality commercial and residential property. Rising income, on the one hand, and the lack of development sites, on the other, causes a continuous increase in prices. The market also lacks true nationwide developers with the largest companies just starting to branch out.

Ukrainian market is attractive for foreign developers not only because of its large size and strategic location but also due to higher yields and shorter payback period for investments in comparison to Central and Western European markets. However, for a foreign company the major difficulty is to get a land plot for development, therefore foreign investors prefer to buy ready projects or arrange partnerships with domestic market players. Local companies are well familiar with the market and know how to deal with such issues as rezoning, building permits, bureaucracy, etc.

Major foreign players that are either present or planning to enter the market are represented mainly by Israel, Austria, United Kingdom, Switzerland, and Russia. They are concentrated mostly in office and retail market sectors since these are more mature and therefore more secure markets for investments.

Kyiv is the most developed real estate market, still attracting most investments. However, regional cities with population over-million, such as Donetsk, Kharkiv, Dnipropetrivsk, Odesa, Lviv, as well as towns with population of over 200,000 inhabitants are also starting to draw attention of developers, especially in the retail sector, because of increasing purchasing power and changing shopping habits of population.

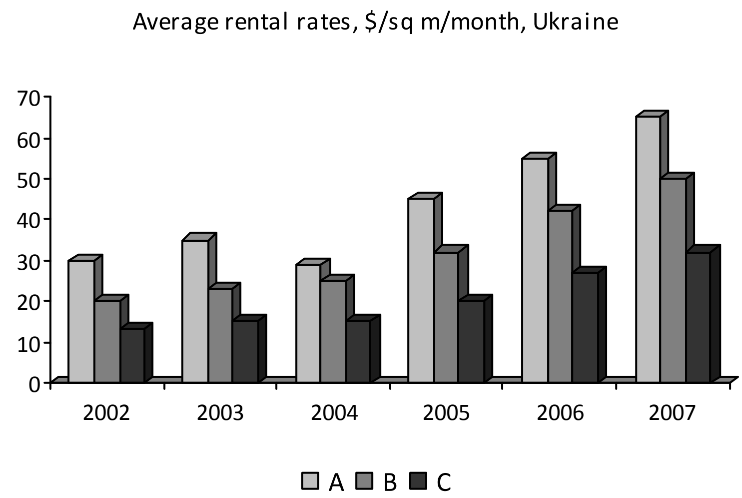
OFFICE MARKET

Ukrainian office market is characterized by a shortfall in the supply of quality office premises (international class A and B), whilst showing healthy demand both from international and domestic companies.

Currently in Ukraine operates around 150 business centers (approx 1300 ths sq m), about two thirds of which are located in Kyiv. Annual growth rates of business centers sq m in Kyiv are about 30-40%, however, even such growth is not enough to satisfy the growing demand. Only in the class A office space, demand is estimated at the level of 1.5-2.0 mln sq m.

Office space vacancy rate in the capital is among the lowest in Europe – around 0.7-1.5%; for the purpose of comparison, in Moscow, Warsaw, and Prague this rate is 5%, 8%, and 11% correspondingly.

Still unsatisfied demand give rise to continuously climbing prices.



Source: CASE Ukraine estimates

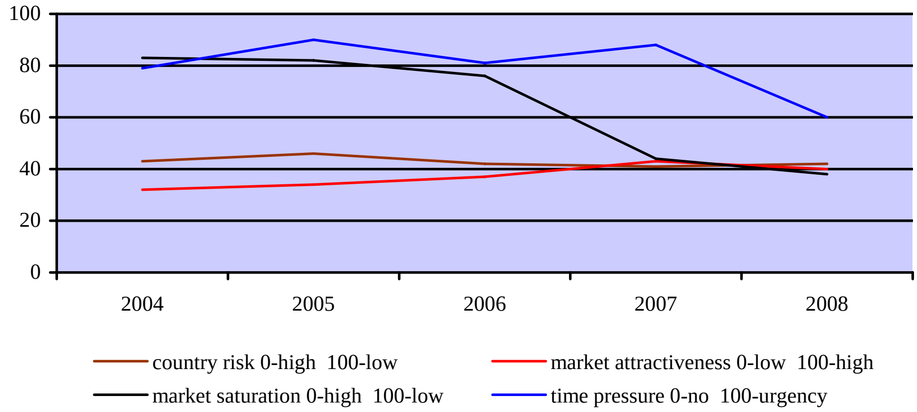
This situation will persist till the market is saturated, which is not likely to happen earlier than in 4-5 years.

Current tendencies of swift development of class A space (taking an increasing share in the total newly-launched supply) and of expanding foreign presence will continue.

Foreign developers are attracted first of all by high yields – this indicator is among the highest in Europe – up to 15% annually. For example, in London annual yields hardly reach 5%, and in Moscow – 10%. Another attractive feature of the market is a shorter payback period for investments – on average it is twice as short as in Europe – 4-5 years versus 10 years.

In 2008 Ukraine stepped down from 5th to 17th place in A.T. Kearney's GRDI rankings. This was mainly caused by high inflation. Nevertheless, Ukraine remains on the radar screen of many foreign retailers. A.T. Kearney's market saturation indicator reflects swift expansion of local retail chains and increasing entrance of foreign players.

A.T. Kearney Global Retail Development Index, Ukraine



Given its fragmented structure and high sales growth rate, spurred by increasing personal income, Ukrainian retail market keeps attracting foreign investors. International retailers began to enter Ukraine in the early 2000s. Metro, Spar, and Billa were some of the pioneers. Massive attack of foreign retailers is still ahead: many international retail giants have just entered or are currently actively looking for retail space in Ukraine. Thus, Auchan opened its first Ukrainian hypermarket in March, and plans on further expansion in partnership with one of the leading local retail chains Furshet. Russian O'KEY entered Ukraine with three hypermarkets in Kyiv and regions. German Praktiker - the first foreign DIY player on the Ukrainian market – opened its hypermarket, while two other European DIY chains are about to enter. Carrefour, IKEA, Ramstore, Casino, just to name a few, are also planning on entering Ukraine.

Until recently most of the attention was focused on Kyiv. However, for many developers the latest frontier is now Ukraine's numerous and populous regional cities. Foreign investors favor regional cities for cheaper and more available land plots. In the regional cities more attention gets food retail, which accounts for almost half of the entire retail market. It is highly fragmented: the top five food retailers have a market share of around 20%.

Demand still far outweighs the supply on both regional and capital retail market. Currently Ukraine-wide retail trade space constitutes about 1.2 mln sq m, approx 400 ths sq m of which - in Kyiv. 61% of total retail space in the regions is concentrated in Kharkiv, Dnipropetrovsk, Donetsk, Odesa, Zaporizhye, and Lviv.

Given the deficit of retail space, rental rates grow from year to year. Today, in prestigious shopping centers of Kyiv rates reach 80-240 $/sq m/month. However, prices differ depending on the location of shopping center and class of rental space, comprising on average around $100/sq m/month. In the regional cities rental rates are not much lower. In the cities with population over 700 ths this number is set at $50-70/sq m/month; cities with population of 200-500 ths enjoy slightly lower rates - $30-40/sq m/month.

Ukraine’s retail market annual yields of 10% exceed the usual 5-7% - in Central Europe, which helps the market attractiveness indicator keep stable.

WAREHOUSE MARKET

Modern warehouse stock (class A and B) in the Kyiv region currently stands at approx 360 ths sq m. About 500 sq m more is in the pipeline for 2008. However, this is still not enough to satisfy the current deficit of warehouse space in the area of Ukrainian capital - 1 mln sq m. By 2010 developers plan to build about 1 mln sq m of warehouses class A and B in the Kyiv region. These projects, if finalized on time, will take the market very close to its saturation.

High deficit is most evident in specialized warehouses segment. Warehouses providing special storage conditions such as temperature, humidity level, etc. are in very limited supply. Many of them are built by large producers or importers for their own needs. Rental rates in specialized warehouses are at least twice as much as in generic ones, bringing to the owners up to 30% of annual yields. Construction of such warehouse should take no more than five months; however, in Ukraine it might take two or three years thanks to red tape and corruption.

Warehouses stock, Kyiv region

	Class A	Class B
Total area, ths sq m	185	175
Vacancy rate, %	0	0.5
Average rental rate, $/sq m/year	115-120	90-115

Source: warehouse market operators, CASE Ukraine estimates

Demand for modern warehouse space is high, and is formed mainly by logistics companies, retailers, FMCG distributors, and importers. The main consumers of warehouse space are logistic operators, their demand comprises about 40% of the total.

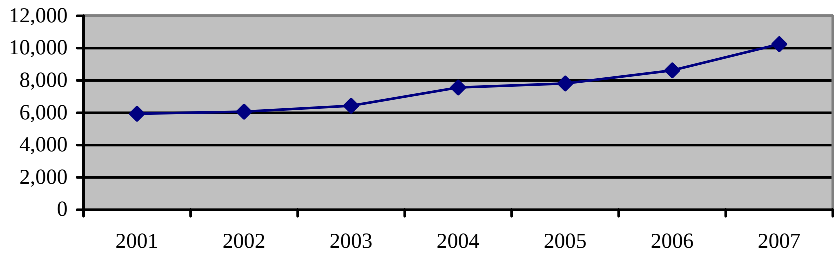
Current rental rates for generic warehouses do not exceed $10/sqm/month, while specialized space can cost up to $30/sqm/month. These prices are twice as high as the European average; however, they are likely to stay at this level for another 2-3 years, until the market is saturated.

Today, many developers, both domestic and foreign, are actively looking for land plots in 30 km zone around Kyiv. However, the main difficulty remains low availability of non-agricultural land, as well as non-transparency in obtaining land plots.

The general pattern of the logistics and industrial market development is expected to follow a decentralized path, with logistic centers developing not only around Kyiv but also Odesa, Dnipropetrovsk, and Donetsk. However, currently in the regional centers modern newly built warehouses are still a rare phenomenon.

Ukraine's residential market continues developing, with ongoing construction activity and growing prices. In 2007, 10,244.0 ths sq m of residential space was put in commission, which is 18.7% more than in 2006.

Housing put into commission in Ukraine, ths sq m



Source: State Statistics Committee of Ukraine

Ukraine experiences substantial house price rises, but it has no official residential price statistics. Ukrainian realtors association reports secondary market rating among Ukrainian cities for the first quarter 2008. Top five cities remain in the list unchanged since 2007, with the exception for Donetsk and Sevastopol which switched places.

Ukrainian residential secondary market rating, 1Q2008

Rating	City	Weighted average price, $/sq m	Price change, % to 4Q2007
1	Kyiv	3,217	+8.0
2	Odesa	1,937	+6.2
3(+2)	Donetsk	1,842	+18.0
4	Dnipropetrovsk	1,805	+13.2
5(-2)	Sevastopol	1,785	+7.0

Source: Ukrainian realtors association

Kyiv residential market has become highly speculative in the absence of efficient saving mechanisms, with individuals buying flats as an investment. Gross residential rental yields in Kyiv range from 6% to 10% per annum. Smaller apartments produce better returns, especially if they are located in historical parts of the city.

High housing prices, today exceeding even the level of those in Warsaw or Prague, most likely will be unsustainable in the long run, especially if the supply side increases. Growth rates of residential prices are already slowing down. Currently the number of deals in Kyiv is declining sharply, which is explained by several factors: chaos created by hryvna revaluation (housing transactions were traditionally denominated in dollar), expectations of prices decrease, and shrinking of mortgage lending.

Residential market is getting less and less attractive for developers, with a switch of investments to commercial projects, first of all, office and trade centers. In the residential sector more opportunities for investors are in developing suburban residential neighborhoods of single-family houses.

Hotel Market

Hotel segment of real estate market is the least developed in Ukraine, the lack of investments is explained first of all by longer payback period compared to other real estate sectors. According to the Ukrainian State Statistics Committee, there are 1,218 hotels in Ukraine, 122 of which are located in the capital.

On the threshold of Euro Cup 2012 Kyiv does not have what to boast in terms of hotel infrastructure. 122 hotels functioning in the capital have only about 9,000 rooms. This is obviously insufficient for Euro 2012, when preliminary estimations predict around 150 ths football fans coming to Ukraine.

The majority of hotels was built during the Soviet era (including some of 4-star hotels), and some of them were reconstructed later on. In Kyiv there are just three 5-star hotels (Premier Palace, Hyatt, and Opera) and eight 4-star hotels (Podol Plaza, Radisson SAS, Riviera, President Hotel, Natsionalny, Perlyna Dnipra, Kyiv, and Impressa). At least 10 more hotels of 3-5* are planned to be put into commission in 2008-2010.

Kyiv hotel market is far from its saturation point, occupancy rates constantly rise reaching now 70-80%. Prices rise as well exceeding the Europe's level by 30-50%. 5-star room rates range in $400-6,000; while 4-star - $150-1,500.

In expectation of Euro 2012 many world-known hotel chains are planning to deliver their first hotels in Ukraine by 2010-2011. Thus, Intercontinental Hotel Group plans to build four hotels in Kyiv (2 – Holiday Inn, Crowne Plaza, and InterContinental). Agreements were as well signed with Hilton and Accor (Sofitel); Rezidor Hotel Group plans to build Radisson Boryspil. Moreover, in 10 years in Kyiv and other cities of Ukraine fifteen 3-star Ramada Encore hotels will appear. The latest tendency of Ukraine's real estate market is construction of mixed-use complexes, majority of which combine office or trade centers and hotels.

Less attention of foreign investors are getting regional cities, where hotel infrastructure is the least developed. Quality hotels lack also the cities hosting Euro 2012: Donetsk, Dnipropetrovsk, Lviv and two in reserve – Kharkiv and Odesa.