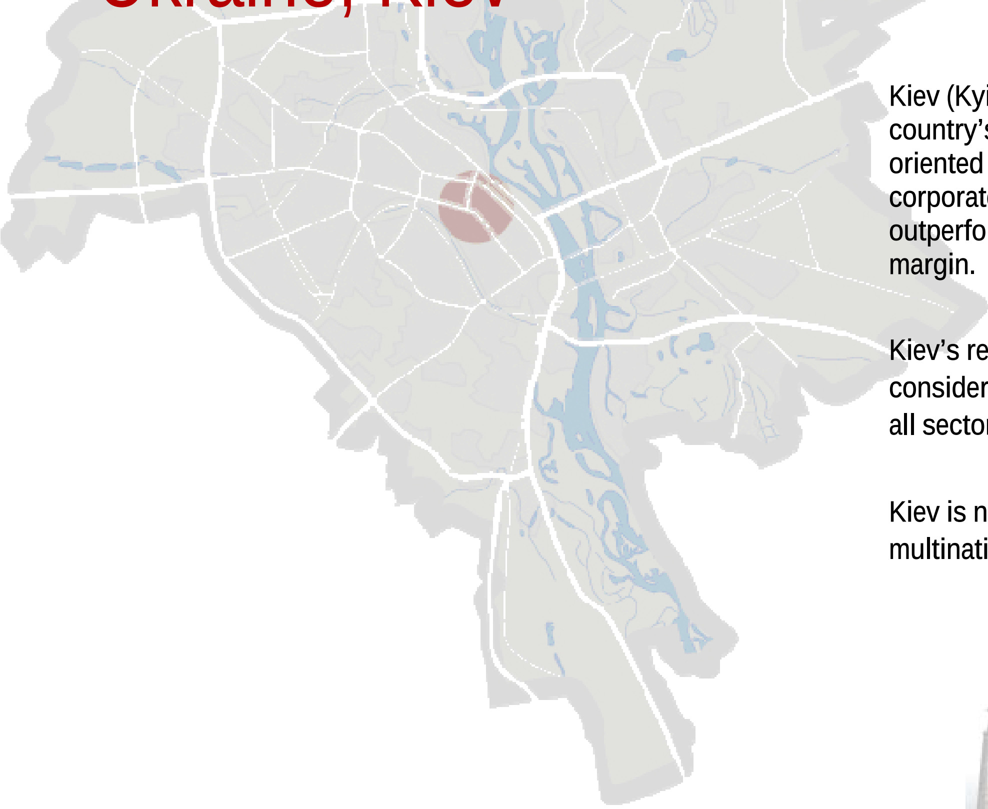
JONES LANG LASALLE

August 2006

Emerging City Winners Profiles: Ukraine, Kiev



Kiev (Kyiv) is the capital of Ukraine, and the country's largest, wealthiest, and most service–oriented economy. In terms of economic output, corporate presence, and share of FDI, Kiev outperforms the rest of the country by a significant margin.

Kiev's real estate market is growing, and the considerable unsatisfied demand evident across all sectors will drive its future development.

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ECONOMIC DASHBOARD

Size	Population (millions 2005)	2.7
	GDP ($ billions 2005)	32
	Employment (millions 2005)	1.35
Growth	Population (% pa 2005-15)	-1%
	GDP (% pa 2006-10)	5.3%
Infrastruct.	Air Passengers (millions 2004)	3.2
Openness	FDI stock ($ billions 2004)	2.7
	Exports ($ billions 2004)	4.13
Wealth	GDP/Capita ($ 2005)	12,000
Education & Labour	Higher Education Institutions (2005)	65
	Enrolled Students ('000s)	430
	Unemployment (% 2005)	<5%
	Average Wage Rates ($ 2005)	280
Business	Business Environment	Semi-Opaque

CITY SUMMARY

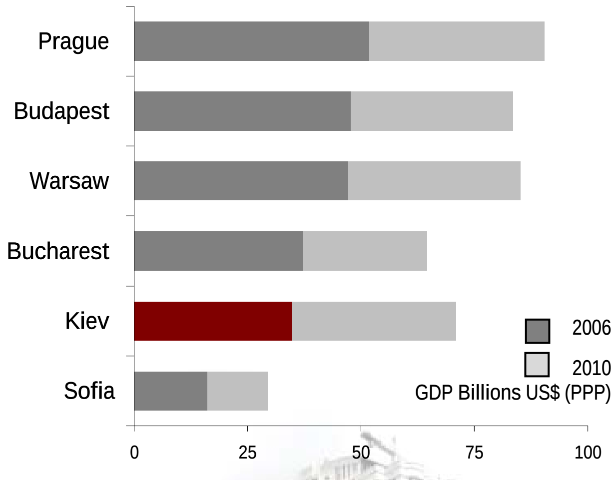
Kiev (Kyiv) is the capital of Ukraine, and the country's largest, wealthiest, and most service–oriented economy. In terms of economic output, corporate presence, and share of FDI, Kiev outperforms the rest of the country by a significant margin. The city is the political, economic, scientific and cultural hub of a 47 million nation which, after regaining independence in 1991, has strived to redefine its political and hence economic position within the "new Europe".

Invigorated by the Orange Revolution in November 2004, the political momentum gained in 2005 has boosted the local real estate markets. Kiev's real estate market is growing, and the considerable unsatisfied demand evident across all sectors will drive its future development. Kiev is now on the radar screens of many multinational companies.

Kiev's real estate market practice shows some parallels with Russia, but its evolution is expected to resemble Central European capitals.

In terms of the quality of product, market standards and practice, as well as its size, Kiev shares many similarities with St Petersburg, where market conditions are being shaped by those of Moscow. However, in terms of city scale, regional and national position, and its proximity to EU markets, Kiev also shares many characteristics with Central European capitals. Comparisons with Warsaw are well placed and the Kiev market currently resembles that of Warsaw of a decade ago. In terms of pace of development Kiev is expected to broadly follow an evolutionary path similar to core Central European capitals, albeit at a faster rate.

CEE Largest City Economies in 2006 and 2010



Excludes Moscow.

Source: BSL Experian, EIU, Eurostat, UN, Jones Lang LaSalle 2006

ECONOMIC BACKGROUND

Kiev is the country's fastest growing economy, and with 5.6% of the country's population, Kiev contributes approximately 20% of Ukraine's GDP and is the destination of c 30% of Ukraine's FDI.

Kiev, together with Ukraine, suffers "a double periphery syndrome", and vacillates between two economic blocks, namely the EU (European Union) and CIS (Commonwealth of Independent States); being attracted by the former, but strongly linked to the latter. Ukraine has gained WTO accession country status and was in the first group of CEE countries (and the first of the CIS) to join NATO's Partnership for Peace co-operation programme. WTO accession is expected this year, while NATO membership could be achieved before the end of 2008.

Ukraine's political and economic prognoses even over the short term remain uncertain. After economic growth slow-down in 2005, the economy is now recovering and further improvement is expected in the mid-term, while the long-term prognosis remains positive. Despite downward revisions, Ukraine's economic growth forecasts (2006-2010) remain amongst the highest in Europe at an average of 5.3% per year.

Despite political independence Ukraine's economy remains linked to Russia. Economic slowdown resulting from unresolved disputes around gas prices, combined with an unstable political outlook, has had a negative impact on the country and hence Kiev's forecast performance. However, with its service-oriented economy, Kiev is expected to outperform the rest of the country and to suffer less from the forecasted economic hardships than the country's production-driven eastern regions.

Ukraine: GDP Growth 2000-08

Source: EIU, July 2006

DEMOGRAPHICS

Kiev's population is stable

Kiev is the largest city of Ukraine with 2.7 million inhabitants living within the city boundaries, and a further 1.7 million registered in the surrounding Kiev Region. Kiev is by far Ukraine's dominant urban centre. Ukraine has a further four cities of over one million (i.e. Kharkiv, Dnipropetrovsk, Odesa and Donetsk), and another four cities (Zaporizhzhya, Lviv, Kryvyy Rih, Mykolayiv) with a population over 500,000.

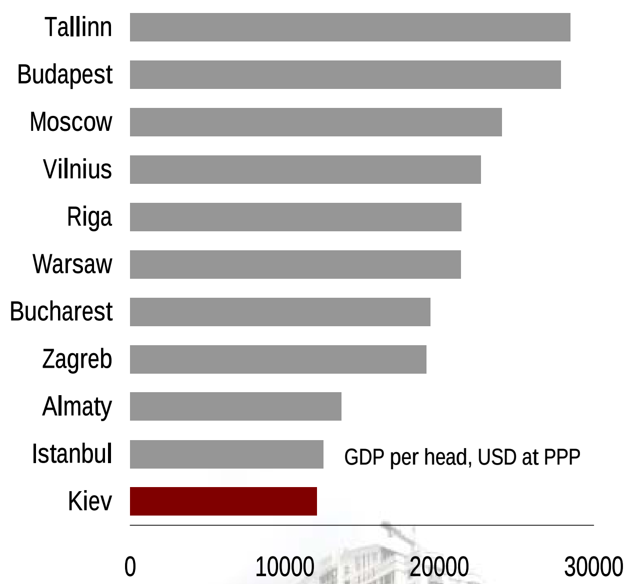
Kiev's population is stable, although is expected to decrease marginally over the next decade, albeit at a slower pace than the rest of the country, Ukraine being one of the world's fastest depopulating countries. Birth rates have fallen sharply in the city, but steady in-migration, mainly of young people seeking employment opportunities, will sustain the population level. Still, Kiev's overall population is ageing and the current share of under-15s is only 14%, while over-65s account for 12% of the population.

WEALTH

Low GRP/capita but high disposable incomes

With a GRP of circa US$12,000 per capita, Kiev is the country's wealthiest region, (75% higher than the national average of US$6,800). However, the city lags far behind other CEE capitals, as Ukraine remains among Europe's poorest nations.

Comparative GDP per Capita (2005)



Source: Eurostat, EIU, April 2006

Nonetheless disposable incomes are relatively high, as Kiev residents are not in general burdened by either high accommodation costs or long term credit responsibilities, thus allowing them to use the majority of their incomes on consumer goods and services (a similar pattern to Russia). This factor, combined with the size of the city, points to significant retail potential.

Opportunities for real estate to reshape Kiev's urban form

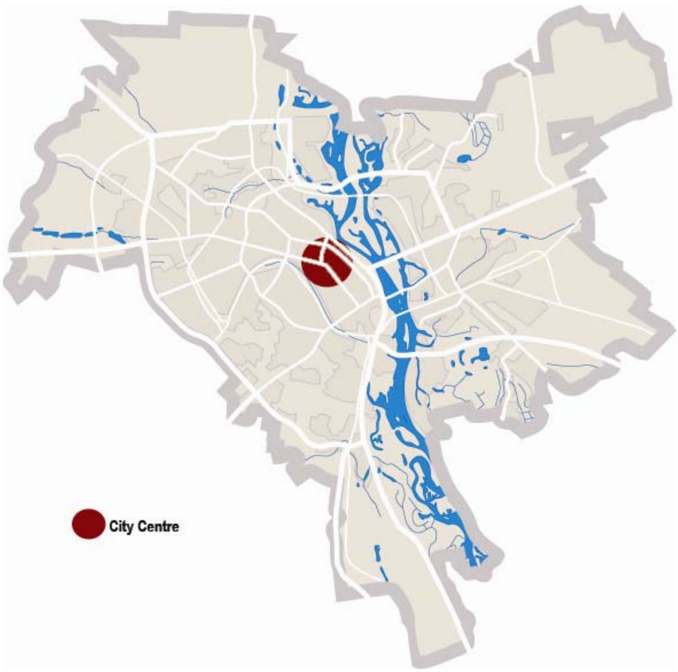
Kiev's monocentric urban form, a legacy of soviet planning, has so far encouraged most new development to occur in the city core, but this is creating significant opportunities for commercial real estate to reshape the character of underdeveloped peripheral districts. Also, rejuvenation of the Dnieper River banks creates a potential for new urban development.

URBAN FORM

Kiev's historical city core has developed on the hilly west bank of the Dnieper River. Most of Kiev's main commercial functions are located on the west bank in the vicinity of the urban core, focused on Hreshchatyk Street (the main thoroughfare).

The development of the Dnieper's eastern floodplain is largely postwar, consisting of multi-residential apartments (housing 1.3 million or 48% of Kiev's population), and is poorly connected to the main core on the west bank. However, planned new bridges will open up new real estate opportunities.

Kiev's Urban Form



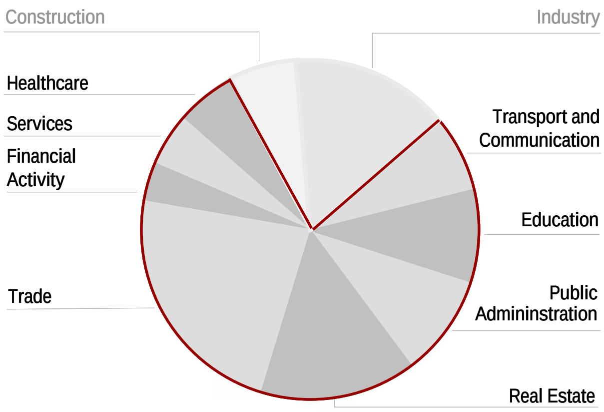
ECONOMIC STRUCTURE

Kiev's economy is more service-oriented than rest of Ukraine

In 2004 1.35 million persons were employed in Kiev, of which 884,000 (or 65.6%) were working in large and medium scale enterprises.

Compared to the rest of the country, Kiev's economy is more service-oriented, reflecting the city's status as Ukraine's commercial and administrative hub. 79% of employment is in services, of which 23% are employed in trade and a further 15% in real estate services. In contrast only 21% of the working population are employed in industrial production and construction. Kiev's service sector accounts for over 82% of the city's GRP, and generates over 30% of total national turnover in the service sector. Kiev's more favourable employment structure has translated into very low unemployment rates, which stand at well below 5%.

Structure of Employment



Source: Central Statistics Department, City of Kiev, 2004

KEY INDUSTRIES / MAJOR EMPLOYERS

The service sectors primarily contributing to Kiev's economy are transport and communications, retail and wholesale, real estate, legal and financial services. Apart from retail, key growth sectors of the Kiev's service economy are:

- IT: Kiev has significant potential to develop as an IT offshoring destination. Cisco, Intel, IBM and Motorola are already operating in Kiev. Clients of Ukrainian IT companies are Boeing, DaimlerChrysler, General Electric, Citibank, NASA, Hugo Boss, as well as SAP Ukraine, Incom, Kvazar-Mikro, S&T' Soft-Tronik and Softline. It is estimated that the volume of the offshore market in 2004 reached around US$ 90 million.
- Telecom: Market is merging in anticipation of a boom. In the first half of 2006 Norwegian telecoms operator Telenor and Russian investor Altimo have been competing in the booming telecom market to buy Kievstar, Ukraine's leading wireless operator. Another Russian telecoms operator VimpelCom in 2005 acquired Ukrainian Radio Systems (URS), the newest and smallest of Ukraine's four mobile companies. Since April 2005, URS has been operating under the Beeline brand name, which is also used by VimpelCom in Russia, and has more than doubled its subscriber base to around 450,000. In July 2006 VimpelCom revealed plans to possibly merge with another Ukrainian operator Astelit. VimpelCom hopes to accelerate its subscriber growth, with a target of between 5 and 6 million customers by the end of 2008.
- Finance: International banking discovers Ukraine's potential. There are currently five main banking companies in Ukraine with foreign ownership: Calyon, Citibank, HVB, ING and Raiffeisenbank Aval. In April 2006 BNP Paribas also entered the market through the acquisition of 51% of shares in UkrSibbank, Ukraine's 4th largest bank.

Production industries, which include manufacturing and construction, employ almost 300,000. Traditionally important industrial sectors of the city's economy have been machine-building, metal-working, engineering, and the food industry.

International companies have been so far present primarily in the food processing industry. Among the biggest are Coca-Cola located in Kiev's Brovary district, and Kraft Foods which in July 2005 opened its packaging factory in Kiev.

Other major employers are active in forestry, woodworking, pulp and paper industries, as well as light industry. Kiev-based world famous companies include Antonov Scientific and Technical Aviation Plant and Paton Electric Welding Institute.

MAJOR CORPORATE DEALS

Corporates are considering but not entering

Ukraine's FDI per capita figures are very low when compared with other countries of the region, and are broadly at the level recorded in Poland back in 1997, before the Polish FDI wave started. Political and economic uncertainties, combined with continued disputes with Russia over energy prices are constraining FDI activity.

The bulk of FDI recorded in 2005 originated from privatization sales, namely:

- The US$4.8 billion repeated privatization sale of the Kryvorizhstal[1] steel mill in Kryvyy Rih (bought by Mittal Steel);
- The US$1.1 billion sale of Aval Bank (to German bank Raiffeisenbank).

Still, Ukraine's progress to privatisation remains uncertain, with some attempts towards the revision and re-nationalisation of recently privatised companies. In the current unstable political environment, government policy to privatization is in continual flux.

Nonetheless, some MNCs are attracted to the growing market opportunities in Ukraine, regardless of the political situation, such as consumer based companies in food and telecoms:

- Russia's second-ranked mobile operator VimpelCom has made an offer to purchase rival Ukraine-based mobile operator Kievstar at a cost of US$5.5 billion, after the acquisition of Ukrainian Radio Systems (URS) in November 2005;
- More recently, Nokia has won a US$75 million contract to expand the network of Ukrainian mobile operator Astelit.

[1] Kryvorizhstal was privatized in June 2004 for US$800 million, against a government-set reserve price of US$714 million, to a consortium, Investment-Metallurgical Union, controlled by then-President Kuchma's family. Offers exceeding US$1 billion from foreign investors were rejected on a technicality. On the initiative of the new President Viktor Yushchenko, the privatization deal was dismissed by court in June 2005.

INFRASTRUCTURE & CONNECTIVITY

Kiev's infrastructure is challenged

Existing intra-urban transport infrastructure is congested and ambitious projects, such as the extension of the metro system, are likely to be deferred due to lack of funds. Connectivity between the western and eastern parts of the city, separated by the Dnieper River, is poorly developed (served by only 4 road bridges).

In terms of road and rail connections Kiev is relatively well connected with eastern Ukraine and Russia and three out of four pan-European corridors running through Ukraine converge on Kiev, linking the city with Moscow, Helsinki, Warsaw and Bratislava. However, the quality of these roads is poor as many of them date back to the post-war period. Major investments are planned and construction is under way on the Kiev – Odesa highway.

Infrastructure improvements are most likely to focus on new bridges and Kiev's two overcrowded airports. Boryspil, the largest international airport in Ukraine, requires substantial upgrading. It currently serves more than 3.2 million passengers yearly, a figure likely to at least double by 2010.

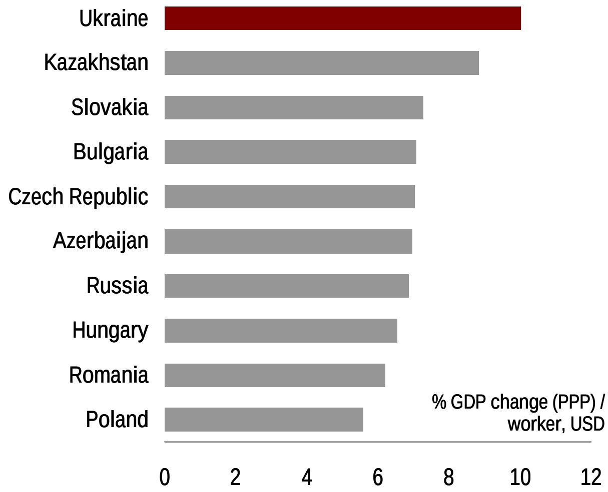
LABOUR & EDUCATION

One of the city economy's greatest assets is its labour supply; labour costs are low and education levels of the city's professionals are high.

Salaries remain low while productivity is growing

Average monthly salaries in Kiev in January 2006 stood at UAH 1,400 (US$280), around 60% higher than the country average, but considerably lower than in neighbouring Central Europe. The gap with Central Europe is expected to widen, with overall labour costs in Ukraine expected to remain stable, while continuing to grow in Central Europe. Matched by an expected improvement in productivity, this should improve Kiev's attractiveness as an offshoring location.

Productivity Gains 2006 – 2010



Source: EIU, 2006

Kiev economy supported by a strong academic infrastructure

Kiev is the largest academic centre of Ukraine and in 2004/2005 over 430,000 students were enrolled into Kiev's 65 higher education institutions. Ukraine benefited from education and research and development programmes implemented under the USSR, which despite some funding cuts after independence, are continuing to create a nation with a heavy emphasis on maths and sciences.

IT programming is a key asset

According to 'Business Week' magazine, Ukraine is fourth in the world in terms of number of IT programmers, and it is the main export item of the IT sector. As an alternative to India, close to EU markets (like Ireland), and with the technical expertise of Moscow, Kiev has significant potential to emerge as an IT offshoring destination, with a large pool of workers particularly adept in the areas of programming and software development.

BUSINESS ENVIRONMENT

Business environment remains difficult

Kiev's business environment in many respects resembles that of Moscow. Ukraine's transition from a centrally planned to a market-based economy has to date proved particularly hesitant and uneven, and the country remains a difficult place to conduct business.

Despite the legal regulations giving some advantages to international investors red tape still exists and the enforcement of property rights is still weak. The tax system remains complex and contradictory, and corporate governance is poor, while the state is still excessively involved in running the economy. In March 2005 the Ukrainian government decided to abolish incentives given to firms operating in its free enterprise zones.

POLITICS & POLICIES

National politics are volatile

The political situation remains highly unstable with frequent changes to parliamentary coalitions resulting in a lack of effective government. Moreover, as Ukraine emerges from the late-March elections, the country's energy situation continues to cause major concern.

Still, the release of strong growth indicators for May 2006 suggests that the economy is doing relatively well even without an effective government.

Kiev's development is constrained

Kiev has the special administrative status of Kiev City State. While gaining some privileges, such as extended independence from central government, the city remains detached from the surrounding Kiev Region, resulting in development obstacles. In 2002, the Kiev State Council approved the Master Plan of Kiev and the Suburban Area Plan until 2020. However, there is no strong evidence of an overall long term strategic vision for Kiev, and most actions are directed at resolving local issues.

Despite its relative economic prosperity, Kiev's development is constrained by the inferior economic situation in the rest of Ukraine. The city's income is feeding the troubled national economy. However, in November 2005 the Kiev Appellate Court upheld an earlier Commercial Court ruling that found the national budget owes the city nearly US$ 200 million, proceeds from privatizing municipal lands and enterprises.

Kiev's new mayor elected

For the last 10 years (until March 2006) the city had been ruled by Oleksander Omelchenko, a professional with a strong civil engineering background, who had implemented several major reforms and had been actively promoting Kiev both domestically and internationally, at events such as MIPIM.

In March 2006 Omelchenko was replaced in free elections by Leonid Chernovetsky, the owner of Pravexbank, a businessman with a legal background. It is expected that Chernovetsky's economic background would translate into smooth city management and improving cooperation with CIS corporates.

LIFESTYLE

A recognised CEE capital

Kiev is both a Ukrainian and Russian-speaking city, more European, but more provincial than Moscow. In terms of city scale, quality of life and built environment, Kiev shows a number of parallels with St Petersburg, but its cultural offer is more limited. During the Soviet era living in Kiev became a highly-prized status symbol, and it could be argued that the city still suffers from a post-imperial syndrome. Nonetheless, Kiev has a reputation for being a quiet and people-friendly city, with large open green spaces and a beautiful historical core.

Kiev has more than 1,500 years of history and splendid architecture spreading on both sides of the Dnieper River. Its hilly landscape and Chicago-like skyline of skyscrapers set the scene for one of the world's finest examples of soc-realistic architecture in Hreshchatyk Street – the main pedestrian thoroughfare, now quickly transforming into a genuine "high street".

Both contemporary and historical Kiev (e.g. St Sophia Cathedral and related monastic buildings, Kiev-Pechersk Lavra, which are on the UNESCO Heritage list) is currently being discovered by international tourism, which in turn will have a positive impact on the city's currently limited leisure offer.

The quality of life in Kiev is better than in the rest of Ukraine – this translates into higher life expectancy: which in 2002–2003 was 70.4 years, with a male lifespan of 65.6 years and a female lifespan of 75.0 years, considerably higher than the country average.

REAL ESTATE DASHBOARD

Market Size/Stock	
Offices ('000s sq m)	539
Retail ('000s sq m)	226
Warehouses ('000s sq m)	200
Hotel Rooms (4-5* Mid 2005)	Limited offer
Market Activity	
Office Pipeline ('000 sq m)	<80
Office Vacancy (%)	>3%
Benchmark Values	
Offices Grade A - Rents (US$ / sq m pa)	650-720
Retail - Rents (US$ / sq m pa)	450-600
Industrial - Rents (US$ / sq m pa)	n/a
Hotels - Room Rates (4-5*) (US$)	250 - 300
Average Residential Prices (US$ / sq m)	1,000 – 2,500
Prime Notional Yields (%)	12 - 13

Source: Jones Lang LaSalle July 2006

JONES LANG LASALLE'S VIEW

Market evolution is similar to CE capitals of a decade ago

The commercial real estate market in Kiev is now developing quickly. Given its size, urban form and geopolitical position, we expect Kiev's market evolution to broadly follow that of other Central European capitals, such as Warsaw of a decade ago.

Demand considerably exceeds existing supply across all sectors, and the Kiev real estate market offers development opportunities across virtually all sectors - offices, shopping malls, retail warehousing and logistics.

The Kiev authorities are anticipating a real estate investment boom, and the city plans to convert former industrial zones into multi-use developments. Projects underway include removing industrial enterprises from centrally located brown field sites of Nyzhnya Telychka, Rybalsky Ostriv, and Podil'ska Harbor. Also local private landowners are keen to partner with international developers, but activity is severely constrained by the inflated land price expectations of local landowners.

The major threat to the development of an active real estate market is land shortages, with a poorly developed commercial land market, lack of land zoning, and considerable red tape involved in land acquisitions.

INVESTMENT ACTIVITY

International developers planning to enter the market

Currently dominated by local developers, international investors and developers are showing increasing interest in the Kiev real estate market, most of which are already active in other CEE and/or Russian markets.

Lack of institutional quality products cools investors

Significant investor interest is currently focused on Kiev, but a limited pool of institutional quality product translates into a lack of investment transactions. The investment market remains embryonic, and it is likely to be some time before investment quality product appears on the market. Many potential investors are increasingly frustrated by difficulties in trying to agree forward purchases or development joint ventures. As a result, the Kiev market is currently attractive to more entrepreneurial developers than investors. Timing is critical as yield compression will continue as the business environment improves and high quality product gradually comes to the market.

Jones Lang LaSalle assesses that current transactions for prime quality retail and office products could achieve yield level around 12 - 13% or below, although as yet this level is not supported by transactional evidence.

MARKET PRACTICE

Market practice reflect Kiev's early development stage

Real estate standards in Ukraine are now being shaped both in terms of development quality and lease terms and they show strong parallels with other CEE markets.

Common Office Lease Practice:
Lease term: 3-7 years, 1 year -Minimum lease term
Rental payments: Monthly or quarterly payments, and 20% VAT
Service Charges: 40 – 80 US$ / sq m pa
Notary Fee: 1% of the full contract value
Security deposit: 3-6 months rent or bank guarantee
Rental increases index: In relation to CPI index
Service charges/taxes: Payable by tenant

Given the limited investment market, developers pay less attention to potential exit strategies, which in turn has had a negative impact on the quality of product in terms of specification, materials, systems, lay out, and space efficiencies. Almost all office and retail developers operating in Kiev are local.

KEY TRANSACTIONS

Investors

Since 2003, when the first investment transaction of Atrem office building was concluded, the Kiev market has seen a few real estate transactions:

- In April 2006, the shareholders of Forum bank sold the 13,000 sq m Leonardo Business Centre to the Irish investment construction company Quinn Group for a figure reported in the region of US$80-100 million. Its office space achieves amongst the highest rents in the city at around US$60 -70/per sq m/month, and accommodates leading worldwide and national companies, including Reuters, Morgan Stanley and MasterCard. The retail space includes UK boutique Karen Millen, Wild Orchid Lingerie, Trussardi and FABI.
- In 2006 Jordanian company Universal Star sold to Apollo Rida the Piramida shopping mall, a 16,700 sq m development on the east bank of the Dnieper River for US$25 million.
- Apollo Rida plans for further commercial real estate acquisitions is testimony to the strong interest of international investors in Kiev's retail market.

Occupiers

The largest office deals (between 1,000 - 4,000 sq m) in 2004 and 2005 have been signed in:

- Podil Plaza - ING Bank, IFC, Philip Morris, PrioCom, Janssen Cilag;
- Forum Business City - Ericsson, WNISEF, Sanofi Aventis;
- 35 Zhylianska Street office building - B.A.T.
- 13/5 Ihorivska Street office building – Procter & Gamble
- Nest Business Centre – Naftogaz Ukraina

The number of deals registered in 2005 and 2006 has been very limited, mainly due to the vacancy rate in A class building being close to zero.

Retail brands are delaying their entrance into Kiev due to lack of quality retail premises on the market. Many international retailers (among whom Russian and Polish brands are particularly active) plan to enter the market. Projects in the pipeline, such as the IKEA MEGA shopping centre (delayed due to unresolved land issues), are already fully pre-let.

Leisure operators are now entering the market, primarily in Karavan shopping centre schemes.

The industrial and logistic market has seen some limited activity:

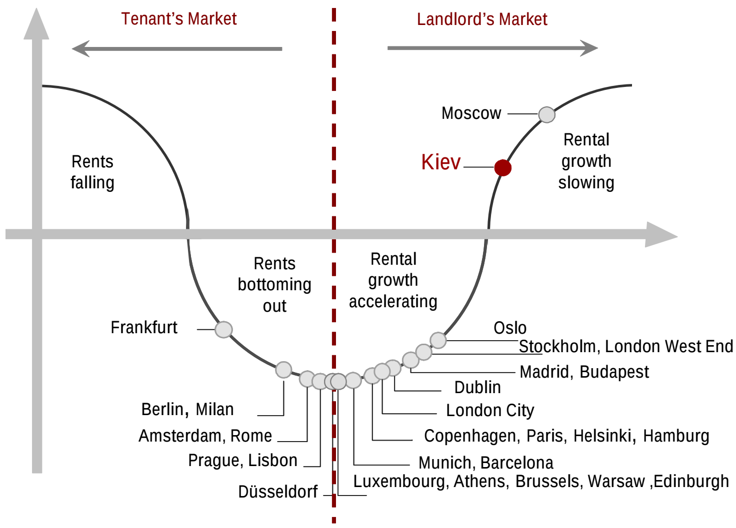
- A 10,000 sq m warehouse in Obukhiv developed by a local company HCM Group was the only project completed in 2005, and was immediately leased to a Ukrainian logistics operator;
- A 25,000 sq m logistic centre developed by FIM Consulting near Chayka airport in 2006 has been fully pre-let to two international logistic operators.

OFFICES

Offices are in strong demand

The total modern office stock is fairly limited at 539,000 sq m, representing only 20% of the current stock of Warsaw, but similar to Warsaw's stock of a decade ago. The vacancy rate is estimated to be between 1 and 4%, and is decreasing. The average office transactions are typically in the range of 50-500 sq m, with foreign companies looking for larger premises of 1,000 sq m and above.

Office Cycles, Q1 2006



Source: Jones Lang LaSalle, 2006

Due to the lack of high quality accommodation, prime rents have grown sharply from US$28/sq m/ month in 2004 to around US$60/sq m/month by Q2 2006; this is triple the rental levels seen in the main Central European capitals.

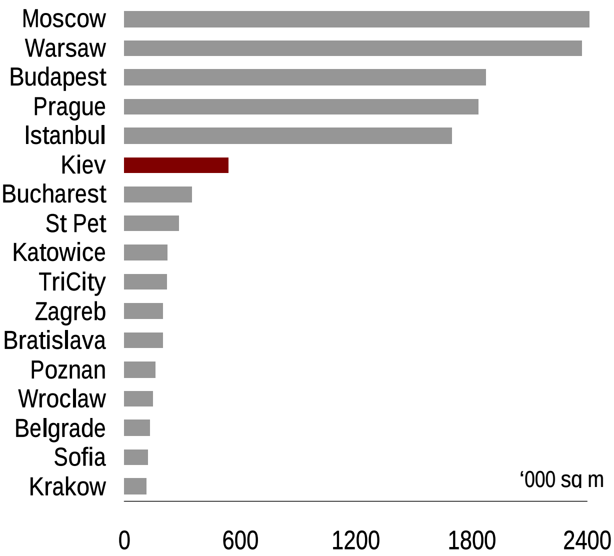
Further rental increases are anticipated due to continued supply shortages. Although the stock is forecast to nearly double by 2007, with 300,000 sq m in the pipeline, the delivery of this new stock is likely to be deferred, not only due to the ongoing economic hardship, but also reflecting common market conditions.

Due to the lack of available construction plots, the majority of existing and planned office stock is B-class refurbishments of old offices or former industrial premises. A-class category applies to only six office projects totaling around 80,000 sq m, namely: Millennium (Ul. Vladimirskaya, 12) - 8,000 sq m; Podil Plaza (Ul. Spasskaya, 30) - 18,400 sq m; Ul. Vetrova 3 - 5,300 sq m; and Solomentsky Business Centre (Ul. Uritskogo, 35) – 11,500 sq m; Leonardo Busines Centre (Ul. Volodymyrska) – 23,200 sq m; Horizon Tower (Ul. Shovkovychna, 42-44) – 13,000 sq m.

Building quality is lower than in Moscow; for example, A-class offices in Kiev are of a similar standard to B+ class offices in Moscow. Mainly due to land scarcity, but also following Kiev's architectural tradition, the predominant architectural form of office building are high (20-30 floor) office towers.

Currently all higher quality office development is concentrated in and around the historic city core, whilst the large projects in the pipeline tend to be located outside the city centre close to main transport linkages.

CEE/CIS Office Stock



Excludes Moscow, Source: Jones Lang LaSalle, 2006

RETAIL

Retail offer growing

Modern retail remains scarce. Western-style shopping malls first appeared in 2002 when the Globus development was opened, a 16,000 sq m underground shopping centre located under the main city square, Maidan Niezalezhnosti. Since then another two higher quality malls have been delivered (Karavan and Mandarin Plaza), increasing the volume of prime shopping centre retail space to 58,100 sq m, while total modern retail space is estimated to be 226,000 sq m. The best shopping centre in Kiev is widely recognized to be Karavan, the first western-style shopping centre with an anchor (Karavan hypermarket) and a managed tenant mix.

Retail pipeline is large

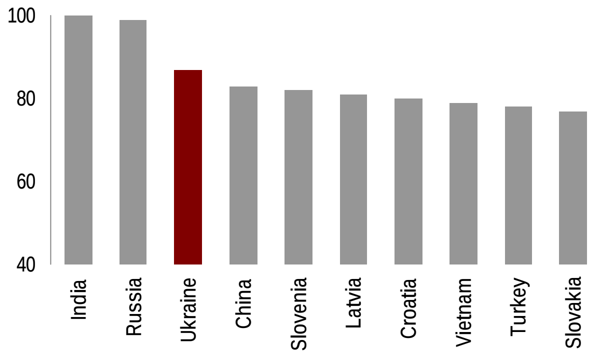
With several international developers planning to deliver modern and large shopping centres in 2006–2008, the retail market in Kiev is showing signs of entering an accelerated development stage. Together with planned IKEA's 130,000 sq m MEGA shopping centre, large scale projects with food courts and entertainment zones, such as Olympic Plaza[2], Europeyskaya Ploschad and Lybid Plaza (delayed), are scheduled to open in the next three years. However, experience shows that only 15 – 20% of announced projects actually get built, due to difficulties with planning permits and project financing. If delivered, these new centres would dominate the market previously occupied by smaller and indigenous projects, but even after these significant project completions, the retail market would still be far from saturated.

Many international retailers are planning a rapid expansion in the super- and hypermarkets sectors, in order to capitalize on the currently underdeveloped state of the retail sector. German retailer Metro has already been operating in Kiev since 2003, and in 2005 Russian department store Paterson opened its first store out of ten planned in the city. Russian Pyaterochka intends to open 30 outlets in Ukraine. Auchan, Praktiker and LVMH are now entering and many others are also poised for rapid expansion: German Lidl, Portuguese Geronimo Martins, and Turkish Migros Turk also have plans to enter the Ukrainian market, alongside expanding domestic retailers such as Fozzy, which in 2005 opened 28 new stores, out of a total of 81 outlets.

[2] Olympic Plaza pictured, due to open in 2006.
Source: www.olympic-plaza.com.ua

Red tape remains a reoccurring entry barrier, as well as a difficulty in acquiring land for stores. While some retailers overcome these difficulties by building their own premises (e.g. Metro), others decide to purchase existing stores (e.g. Russian Perekryostok acquiring Ukrainian Spar). Despite difficulties, foreign retailers are keen to invest in Ukraine. In 2005 AT Kearney's Global Retail Development Index ranked Ukraine as the third best market in the world in terms of retail opportunities after India and Russia, an impressive move from 20th position only three years ago.

Global Retail Development Index



Source: A.T. Kearney, 2005

Kiev has a strong High Street

Unlike many others CEE cities, including Warsaw, Kiev city centre is organised around its "high street", Hreshchatyk, the main thoroughfare of the historical core of the city, rebuilt after the WWII in fine soc-realistic style. The street, pedestrianised during weekends, is now the prime shopping location of the city where a number of international brands are seeking to open their flagship stores.

Existing and planned retail remains disproportionally focused on the historic core, and we expect city core locations to continue to dominate the retail market. However, significant opportunities for retail development in other locations are now crystallizing, along the streets such as Gorodetskovo, Lva Tolstovo, and Podol.

INDUSTRIAL

An active warehousing market yet to emerge

The logistics and industrial market remains underdeveloped mainly due to the lack of industrially zoned construction plots, as well as a lack of successful case studies proving the feasibility of industrial development. However, this should change soon as with the growing demand both local and international players are now being active on the market.

The general pattern of the logistics and industrial market development is expected to follow a decentralized path, similar to Poland, with logistic centres developing not only around Kiev but also in Odesa, Dnipropetrovsk and Donetsk, in proximity to the strong secondary markets. Emerging market practice resembles CEE.

The standard of existing old premises is low. Modern facilities, such as full-height loading bays or adequate flooring are rare, and mainly owner occupied by logistics and industrial companies such as Frans Maas and Kuehne & Nagel. As a result, there is currently a major shortage of good quality warehousing space in Kiev, and modern, western standard leasable warehouse space is virtually absent. Major western corporations are willing to pay high prices and have been conducting their own renovations or settling for mediocre space.

Due to the rapid growth of international interest, in 2005 the construction of two large commercial projects was launched, namely Obukhiv Commercial Warehouse (third and largest phase, developed by Orange) and the first Europolis warehouse park, Kiev Ring Road Logistics Complex.

RESIDENTIAL

Residential prices still growing

The residential market in Kiev is developing quickly, with high construction activity and growing prices. The residential market has become highly speculative in the absence of efficient saving mechanisms, with individuals buying flats as an investment. High residential prices, currently at the level of those in Warsaw or Prague, are thought by many local specialists to be unsustainable in the long run, especially if the supply side increases.

Investment risks remain, as illustrated by the high profile case of the Elite Centre residential project, where in March 2006 the developer absconded with advanced payments made by individual investors. Advance payment schemes are popular in Kiev's demand-driven residential market.

HOTELS

Boom in the hospitality sector on the horizon

Demand for high quality hotels in Kiev remains unsatisfied, and thousands of apartments in the city are being leased as hotel rooms on a daily basis. High class stock is extremely limited and existing hotels operate with nearly full occupancy during the week and are able to charge healthy rates.

Tourist as well as business activity in the city is growing, and the future of the Kiev hotel market is very promising. With international arrivals forecast to grow by 70% by 2010 (representing the largest increase across the region), Ukraine's capital is expected to develop into a major tourist and business destination. In terms of the number of international arrivals, Ukraine is expected to outperform Poland by 2010 and considerably narrow the gap with Russia, becoming the second largest destination in the region.

The Kiev quality hotel market is developing fast, with a large pipeline. The Radisson SAS Hotel opened in 2005, whilst the Saint Sophia Hyatt Regency, the Opera Hotel, the Rixos Hotel Kiev, and the Riviera Hotel are all planned to open in 2006. In April 2006, Hilton International announced the construction of a five-star hotel to be completed by 2009. Operators' interest remains very positive.

Apart from Kiev, hotel infrastructure is starting to develop in the popular tourists destinations on the Black Sea coast in Crimea.

FINAL OBSERVATIONS

Kiev market to become more international

Kiev has all the characteristics of an emerging real estate market, being developed primarily by the local players. As Kiev remains relatively undiscovered as an FDI location, the majority of existing demand is created and satisfied primarily by domestic companies. Lack of international participation has resulted in underinvestment and inferior quality of commercial buildings as Kiev's developers have tended to repeat the same mistakes already made in other emerging markets such as CEE or Russia. Still, while the Kiev market becomes increasingly integrated with the global market, and as an ever growing number of established real estate market players are appearing in the city, market standards will improve.

Kiev has many preconditions of a successful real estate market, where considerable underdevelopment is matched by huge demand, while comparisons with smaller CEE capitals such as Warsaw, Prague and Budapest show the real scale of potential. Unsatisfied demand will remain one of the market's features in the mid- to long-term, should the country's political and resulting economic situation remains reasonably stable. Kiev is not just a promise of a market, it is a genuine opportunity.

Jones Lang LaSalle, August 2006

DEFINITION OF TERMS

ECONOMIC DASHBOARD

Population: Population of City of Kiev in its administrative boundaries

GDP (GRP): Gross Domestic Product of Ukraine (Gross Regional Product of City of Kiev).

Employment: Economically active population of Kiev between 15 and 70 years of age.

Exports: The Central Statistics Department in the City of Kiev on export and import of Kiev's enterprises and organizations in 2004, USD millions.

FDI: Foreign Direct Investment or the total amount of non-residents' capital accumulated during the years of Ukrainian independence in the city's economy, USD millions.

Business Environment: Jones Lang LaSalle assessment of a locations macro economic environment, its policy towards private enterprise and foreign investment, and its real estate market.

REAL ESTATE DASHBOARD

Offices Stock Class A and B: Refers to the total completed office space (occupied and vacant). Class A describes an above average property in the market, having high quality standard finishes, state-of-the-art-systems and good accessibility. Class B refers to the average office buildings.

Office Pipeline refers to the total amount of grade A and B office space under construction, and completion expected in the next 24 months.

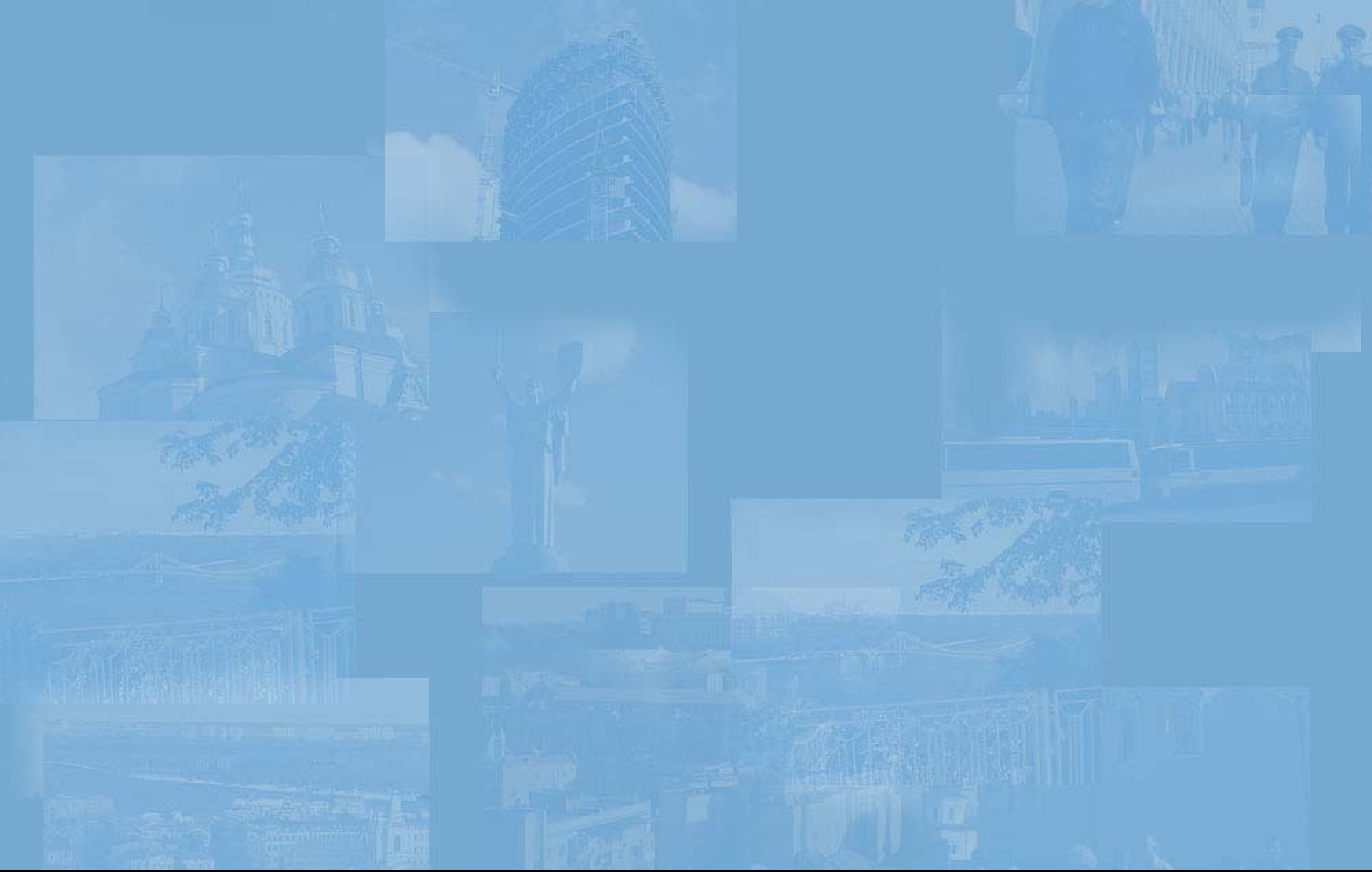
Office Vacancy represents completed floorspace offered on the open market for leasing or sale, vacant for immediate occupation on the survey date (normally at the end of each quarter period), within in a market.

Prime Benchmark Rents represents the top open-market rent that could be expected for:

- Prime Office Rent: a notional office unit of over 500 m² of the highest quality and specification in the best location in a market, as at the survey date (normally at the end of each quarter period).
- Prime Retail Rents: a notional prime position 100 m² Unit Shop situated in the prime retail location in a market or a notional prime position shop situated in a specified Shopping Centre.
- Prime Industrial Rent: a notional distribution warehousing unit of the highest quality and specification in the prime location within a market, of over 5,000 m² gross internal space and with ceiling heights over 8 metres.

Residential Prices: Refers to typical prices (within a range) for high end residential projects in US$ per square meter.

Prime Benchmark Yield: Refers to the best (i.e. lowest) yield estimated to be achievable for a notional office property of the highest quality and specification. Benchmark yield represent Jones Lang LaSalle's "market view", based on a combination of market evidence where available, and a survey of expert opinion.



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