

Construction and building materials market in Ukraine



InvestUkraine

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Dear Reader,
It is my great pleasure to introduce you to our new publication about attractive sectors of Ukraine, made in partnership with Deloitte.

We developed these brochures to make information about sectors of Ukraine accessible and easy to understand. The booklets provide analysis of economic attractiveness, as well as comparative characteristics and undiscovered opportunities.

Ukraine enjoys a long industrial tradition, robust transportation and technical infrastructure, rich natural resources, strong secondary and tertiary education, a broad network of research and development institutes, and a large pool of technically skilled labor. As a WTO member since 2008 and having signed International Agreements for the Avoidance of Double Taxation with 63 countries, Ukraine is a fair player in the business world, a transparent and predictable partner.

InvestUkraine offers individual support to investors and is here to assist potential investors with setting up production in Ukraine. We offer professional support in obtaining information and analysis, legal advice, site visits, site selection services, assistance in communication with local authorities, and an aftercare program.

I encourage you to consider Ukraine as a place for your future business and discover all the benefits of locating your company's operations in our country.

I look forward to welcoming you in Ukraine.

Sergiy Yevtushenko,
Head
InvestUkraine
State Agency for Investment and
National Projects of Ukraine



A favorable geographic position, vast consumer market, ample resources and high level of education – all these factors ensure great investment potential for the economy of Ukraine.

At present, Ukrainian market is at the development stage. There are many niches and opportunities for introducing new players and strengthening the positions of existing ones. However, most of Ukraine's industries lack investments, though international investors are highly interested in them. We believe that foreign investments will be very successful and promote economic growth if a favorable investment climate is created in Ukraine.

To assist you in determining the most promising areas to invest in and get an insight into Ukrainian market, Deloitte experts in cooperation with InvestUkraine have conducted this research.

We hope that this overview will be useful and interesting for all companies interested in investing in various industries of our country.

Vladimir Vakht,
Managing Partner
Deloitte

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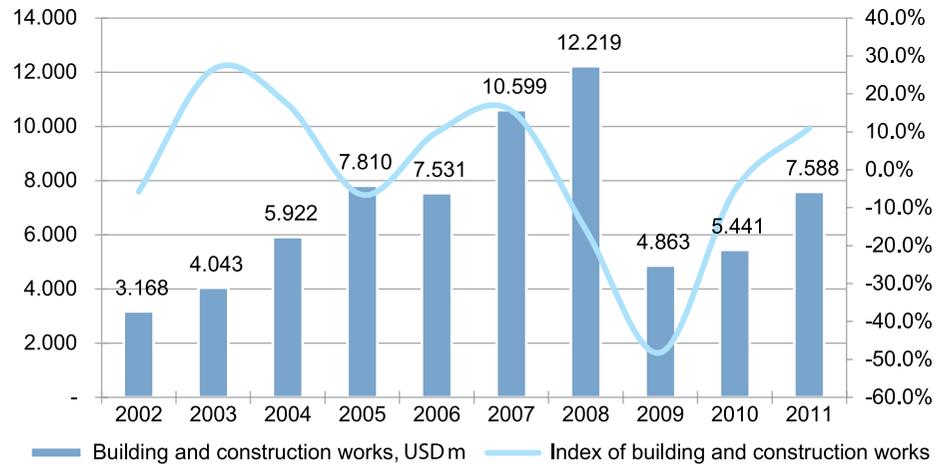
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1. Executive summary

Having passed recession of 2009 Ukrainian economy is coming back on the way of recovery. Construction industry is not an exemption. Here growth rate accelerated and reached 11.1% YoY in 2011. For 2002-2008 sector volumes more than tripled

demonstrating growth by 25.2% annually. Despite sufficient current growth rates market volume in monetary terms is still far below pre-crisis numbers, mainly due to devaluation of national currency by 48% that occurred in late 2008.

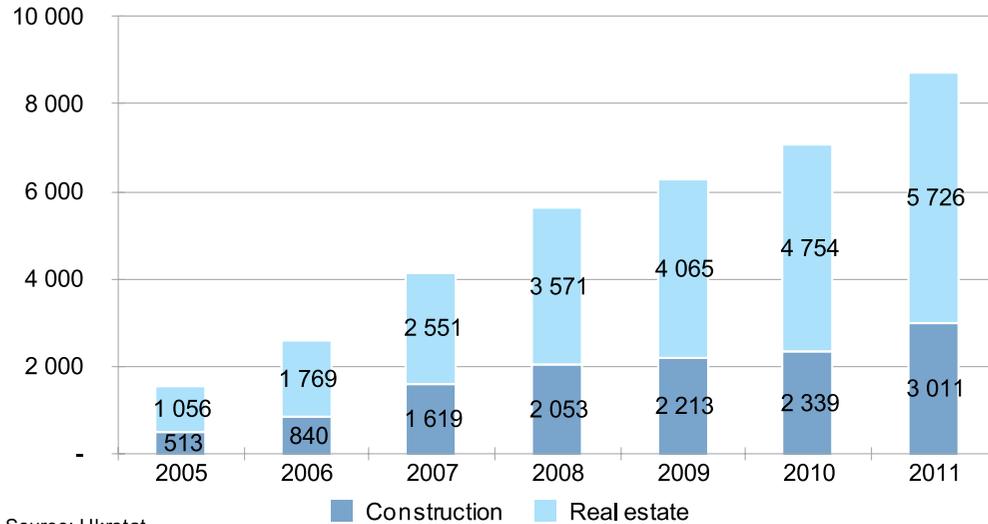
Dynamics of building and construction works



Source: Ukrstat

Around USD 8.7 bn or 17.7% of total inward FDI which came to Ukraine represents construction and real estate sector indicating fundamental interest in the sector by foreign investors.

FDI in construction and real estate, USD m



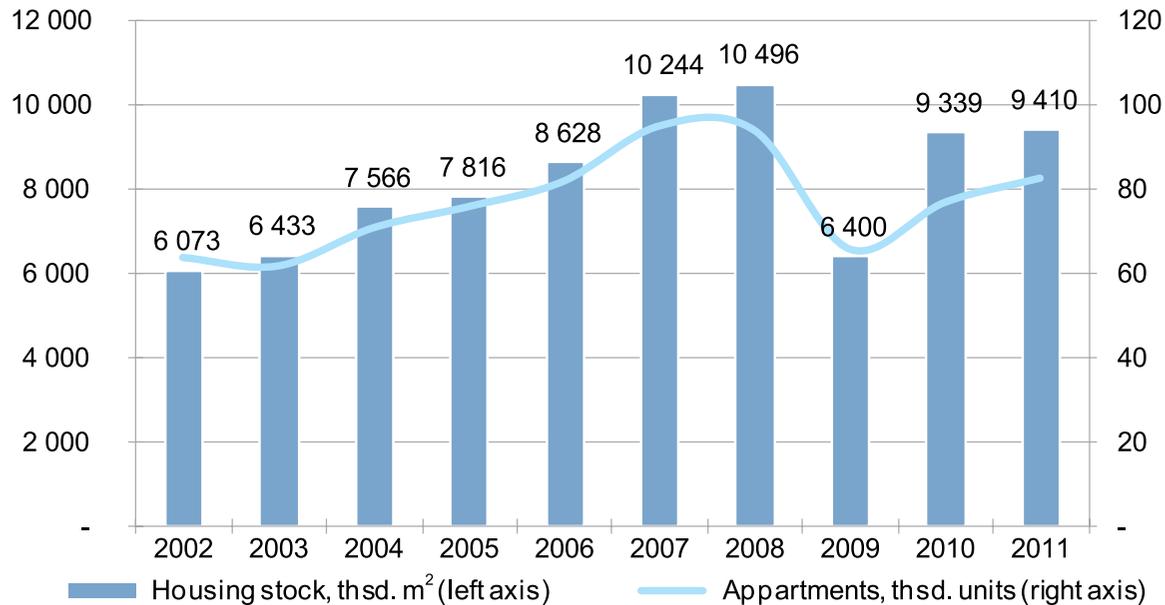
Construction sector demonstrates huge potential for growth, first of all due to low rates of existing stock per capita (23.3 m² per person) and dated residential housing. Besides, a share of construction in GDP structure of Ukraine equals only 3%, while world average figure is about 13.4%.

Based on market requirements, the construction and real estate market can be basically classified into the following classes: residential, non-residential (retail, office, warehouse, hotels) market and the market of construction materials.

2. Overview of residential construction

After deep downturn in 2009 residential construction market is showing signs of recovery. In 2011 there were completed about 82.7 thsd apartment units or 9.4 million m² of housing stock, while the total area of stock reached 1,089 million m² by the end of 2011.

New housing stock and units of apartments completed



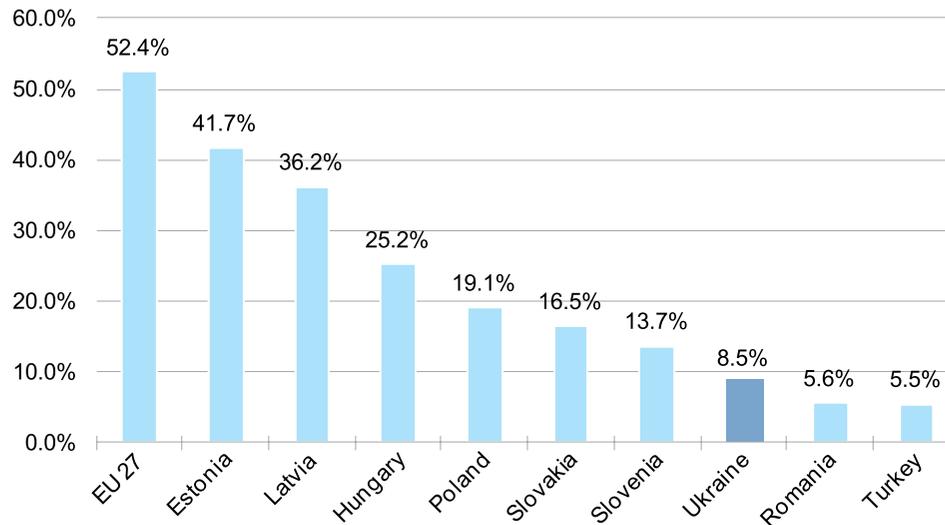
Source: Ukrstat

The number of constructed apartment units rose from 2002 to 2008 with CAGR of 39%. According to Ministry of Justice¹ size of market in monetary terms concerning apartments and houses purchase deals increased by 7.1% in 2011 reaching USD 19 bn. The

number of deals rose by 10.6% to 491.7 thsd, while deals on mortgage equaled only 7% of total, which is quite a low rate in comparison with other countries of the region.

¹The Ministry keeps records of deals on housing in Ukraine

Residential mortgage loans as % of GDP (2010)

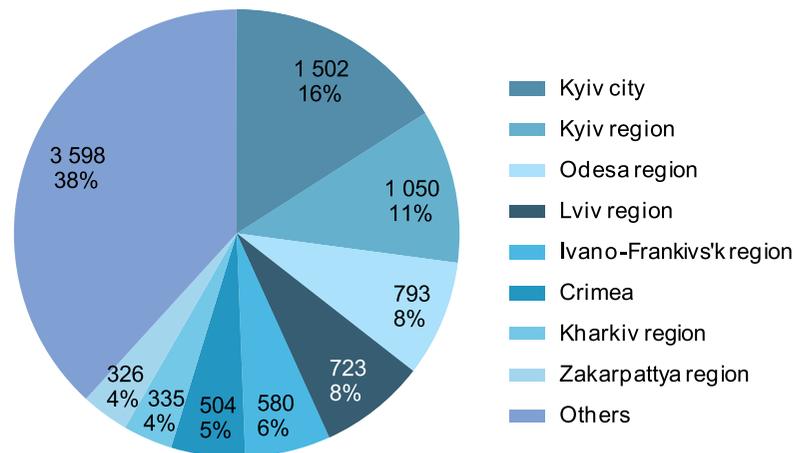


Source: European Mortgage Federation

Residential construction is characterized by some geographical imbalances between metropolitan area of Kyiv, Kyiv region and other regions. In 2011 the share of Kyiv and Kyiv region amounted to 27.1%,

with another 27.7% of residential construction performed in Odesa, Lviv, Ivano-Frankivs'k regions and the Crimea, while the part of heavy populated eastern regions is quite low.

Structure of residential construction by regions in 2011, thsd m²

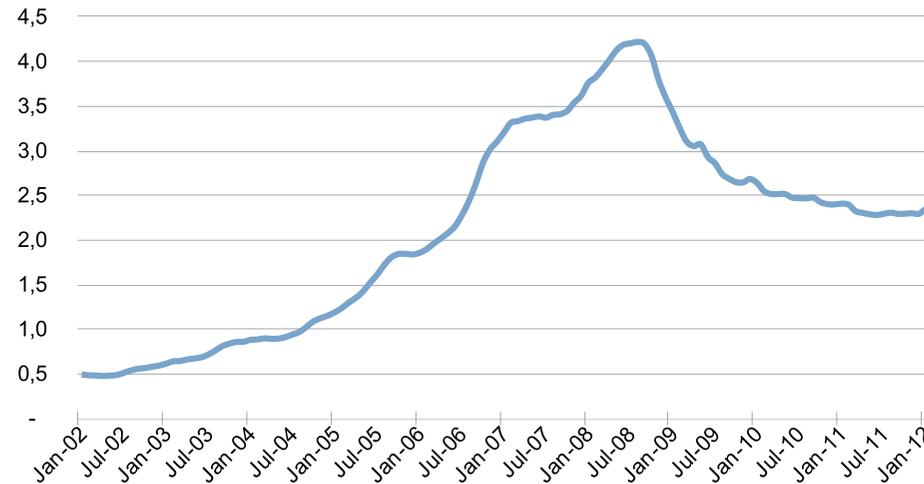


Source: Ukrstat

Prices for residential housing in Kyiv gained impressive 43% annually for the period of 2002 and mid of 2008 when they reached historical maximum. As a result of decline in economy and reduction in demand

as well as devaluation of Ukrainian currency a downward trend in house prices has been observed in the following periods stabilizing in 2011.

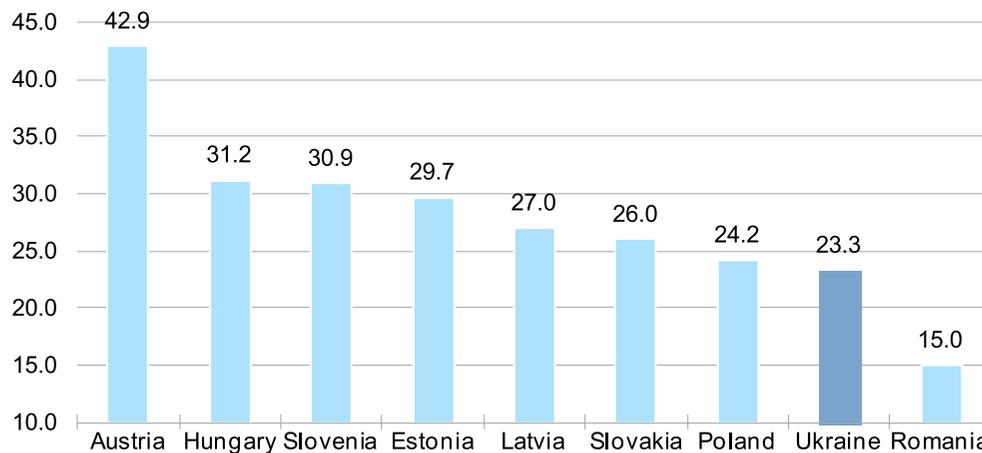
Price dynamics on residential real estate in Kyiv, USD thsd per m²



Source: Blagovist

Average floor housing space per person in Ukraine remains low compared with other countries in the region demonstrating potential for growth and demand for residential housing.

Average useful floor area per person, m²



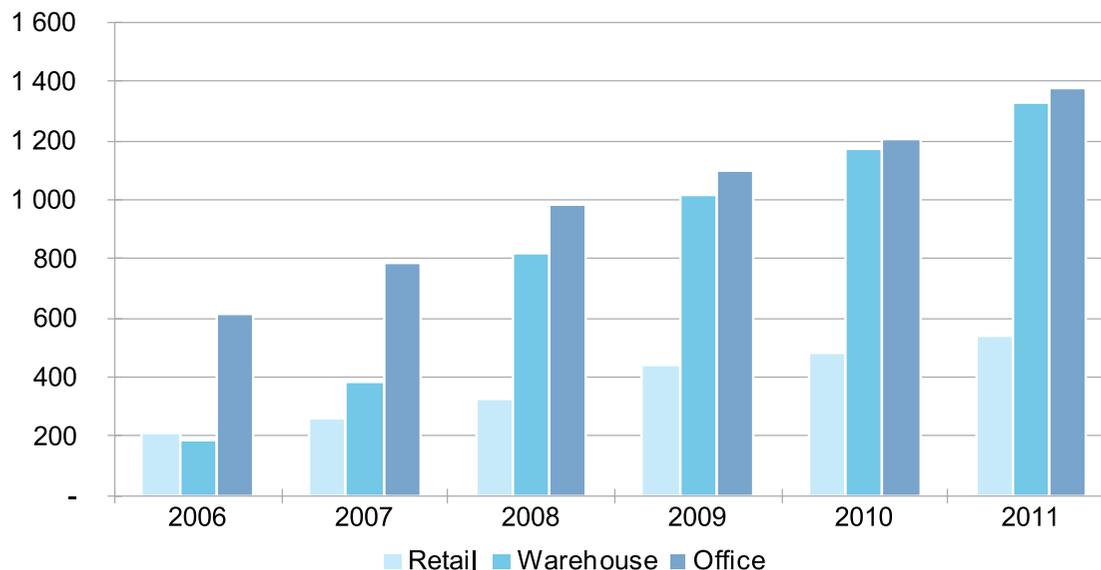
Source: OTB Research Institute for the Built Environment / 2010, Ukrstat / 2011

3. Overview of non-residential property market

Kyiv, Kharkiv, Dnipropetrovs'k, Donets'k, Odesa and L'viv are major Ukrainian cities, which have been attracting particular interest from retailers, developers and investors. Nevertheless major activi-

ties in commercial (non-residential) market just as in case with residential market are concentrated in Kyiv and Kyiv region.

Non-residential stock supply in Kyiv, thsd m²



Source: Colliers International, Jones Lang LaSalle, DTZ Research

Supply

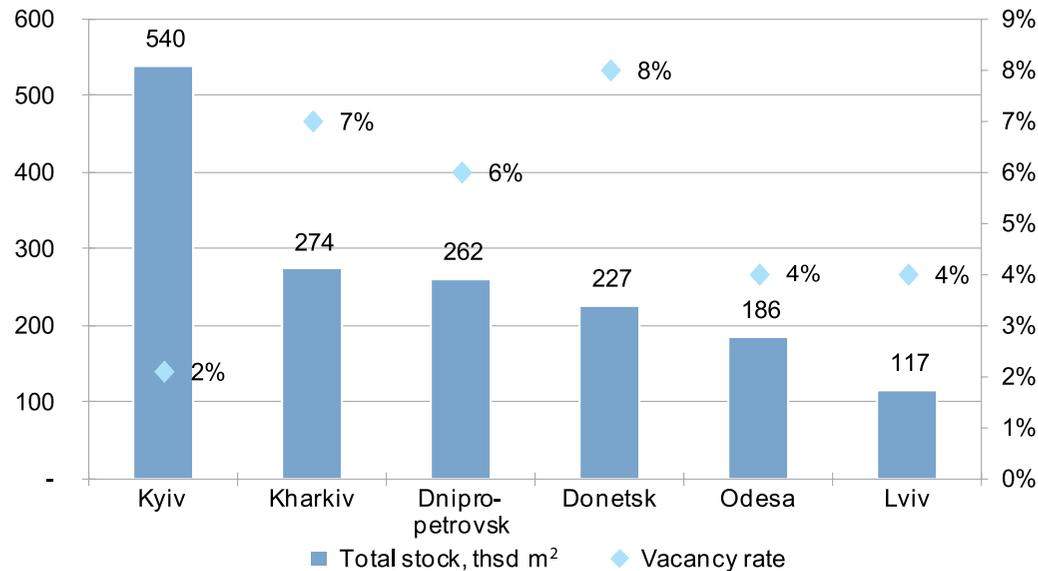
Retail

In 2011 total existing modern retail stock in these six cities exceeded 2.6 million m², on average amounting to 200 m² per 1,000 inhabitants.

Modern retail stock in Kyiv has risen from 2006 to 2011 with a CAGR of 20.8%.

New supply was limited to two shopping centers (55 thsd m²) in 2011 and reached 478 thsd m². It is expected that 185 thsd m² will be added in 2012. In 2011 such brands as Christian Dior, Ermanno Scervino, GAP, New Yorker, Oysho and others were launched in Kyiv.

Retail stock and vacancy rates (as of 2011)



Source: Jones Lang LaSalle

The retail property market throughout Ukraine remains largely underdeveloped in terms of its saturation and variety of formats in the existing properties (retail parks, fashion outlets).

Offices

In 2011 there was completed 170,865 m² of quality office space. This was higher than new ones over the last three years (total office stock 1.3 million m²). During 2006-11 Kyiv office market experienced growth by 17.5% annually. In 2012 about 270 thsd m² is expected to enter the market. This will be the largest completion volume on modern office market. Despite significant growth in recent years Kyiv's modern office stock remains low. Office stock per capita is one of the lowest in Europe, indicating significant potential for further office sector development.

Warehouses

New supply of warehouse stock was comprised of 150 thsd m² in 2011, which is about the same as in 2010. Total stock of modern warehousing and logistics in Greater Kyiv area reached 1.3 million m² by the end of 2011.

Hotels

The Kyiv hotel market comprises of 79 hotels (totaling 1,731), 47 of which are classified hotels (1-5 stars). The number of hotel rooms per 1,000 inhabitants in Kyiv stands at 2.7, which is far below the level of Warsaw – 6.3 or Bucharest – 6.

In 2012-2014 perspective, it is expected that several more high-end hotels under international operator management will be built in Kyiv. Those include: Fairmont (five-star, 259 rooms already operating), Hilton (five-star, 257 rooms), Swissotel (five-star, 513 rooms), and Holiday Inn (four-star, 210 rooms). Currently, there are a total of 19 three-star hotels in Kyiv and only few of them are managed by international operators.

Demand and vacancy rates

Global financial turmoil of 2008-09 had direct influence on decrease in real GDP of Ukraine, personal wages, increase as well as decline in private consumption. Demand on commercial property has contracted as well, which reflected on vacancy rates.

Economic overview

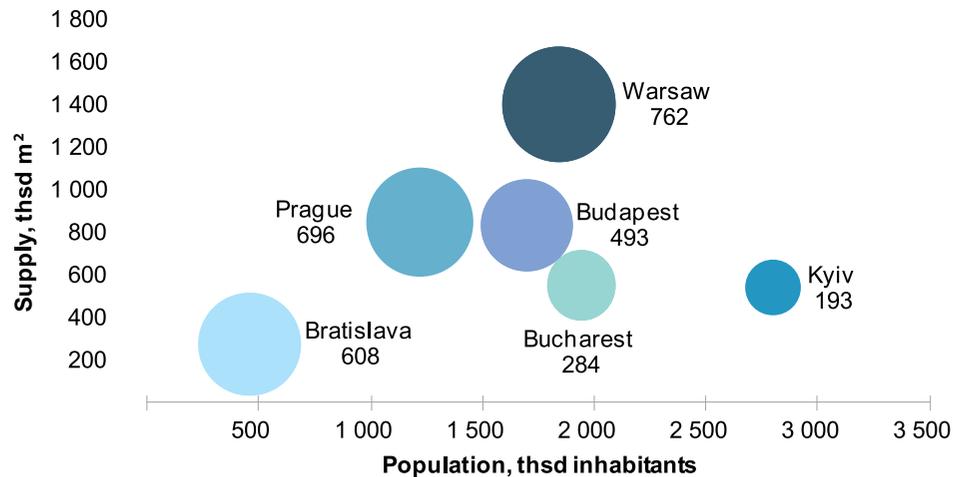
	2006	2007	2008	2009	2010	2011
Real GDP growth	7.3%	7.9%	2.4%	(14.8)%	4.2%	5.2%
Industrial production	6.2%	7.6%	(5.2)%	(21.9)%	11.2%	7.3%
Growth in retail turnover	26.5%	28.9%	18.1%	(17.4)%	9.8%	14.7%
Private consumption, USD bn	64.3	85.1	112.0	75.6	105.6	122.4
Real wages growth	18.3%	12.5%	6.3%	(9.2)%	10.2%	8.7%
Unemployment	6.8%	6.4%	6.4%	8.8%	8.1%	8.0%
Exchange rate UAH:USD, ave.	5.05	5.05	5.27	7.79	7.94	7.97

Source: Ukrstat, Economist Intelligence Unit

Real wages growth and improved bank lending activity stimulated retail trade growth by 14.7% in 2011 compared to the same period of 2010. In 2011 the total retail market amounted to USD 84 bn. Currently demand for modern retail space in Kyiv shopping centers slightly exceeds supply. This is evidenced

by a low vacancy rate of 2.1% in operating shopping centers. Many successful shopping centers have no vacant space, and there is a waiting list of potential tenants. The Kyiv retail market remains fundamentally undersupplied in comparison to other European capitals.

Saturation of retail stock, m² per 1,000 inhabitants (as of 31 December 2010)



Source: CB Richard Ellis, Colliers International

Primary market-wide vacancy on the Kyiv office market reached 15.8% in late December 2011, increasing from 12.7% at the end of 2010, but remaining lower than 17.4% registered at the end of 2009. The increase in vacancy at the end of 2011 was mainly due to recently delivered projects, significant amount of which was not as yet ready for practical occupation.

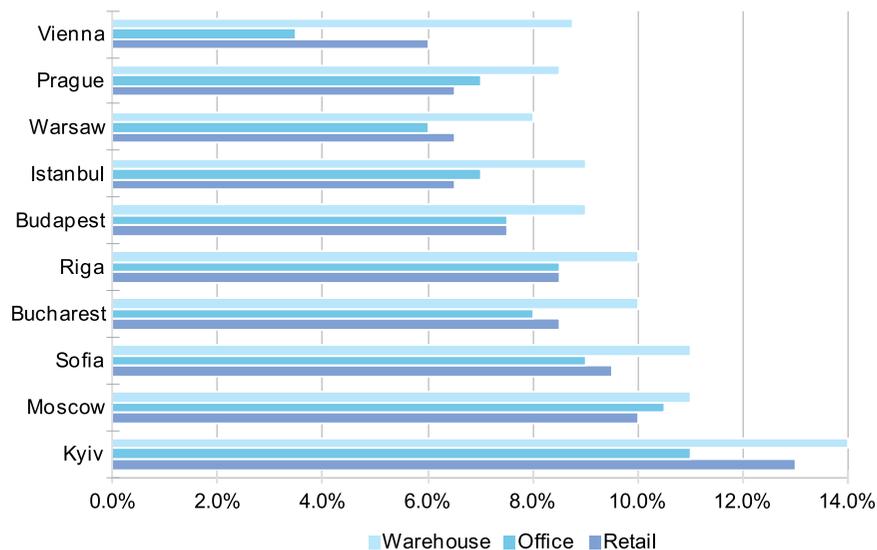
Low supply of new premises and increasing demand for warehouse premises pushed the vacancy rate from 17.9% to 15.7% in first half of 2011. As a result of retail turnover growth and retail/logistics operators' expansion increase is expected in demand for warehouse premises.

In 2010 the number of foreign tourists to Ukraine increased by 2% compared to 2009. According to Ukrstat in 2010 the number of foreign guests comprised 21.2 m people. It is worth mentioning, that typically demand for top-end segment hotels is driven by foreign travelers. According to Boryspil Airport data passenger traffic reached 8.0 m people in 2011 increasing by 19.4% YoY (2010: 6.7 m). The growth of passenger traffic of the county's main airport proves gradual business activity recovery in Ukraine, and Kyiv, in particular. As a result, increased demand for hotel rooms lead to increased occupancy in high-end hotels, on average, up to 60%.

Prime yields and major transactions

Prime yields on Kyiv commercial property remain the highest in the region.

Prime yields on commercial real estate (as of 31 December 2010)



Source: Colliers International

Total value of M&A deals on commercial real estate in Kyiv comprised about USD 400 m in 2011, which is twice as much as the previous year.

Largest open-market transactions on commercial property for 2010-11

Purchase	Seller	Asset	Estimated value, USD m	Year
ESTA Holding	Yaroslaviv Val	Class A Leonardo Business centre (Phase II)	135	2010-2011
TV channel 1+1	IBC Stolitsa	Business centre Shchekavytskyi	25	2011
Monkar Limited	XXI Century	Shopping centre Kvadrat in Lukianovka	14	2011
Fozzy Group	Nova Liniya	Kyiv hypermarket	over 10	2011
ESTA Holding	Trade House "Kyiv TSUM"	Kyiv TSUM (Central Department Store)	100	2010-2011
Oledo Group	Astra Property	50% + 1 share in the retail and leisure centre Sky Mall	30-45	2010
DUPD	Arricano Trading Ltd	35% interest in 5 retail projects throughout Ukraine	35	2010
Raben Ukraine	Parkridge	Warehouse complex	13	2010

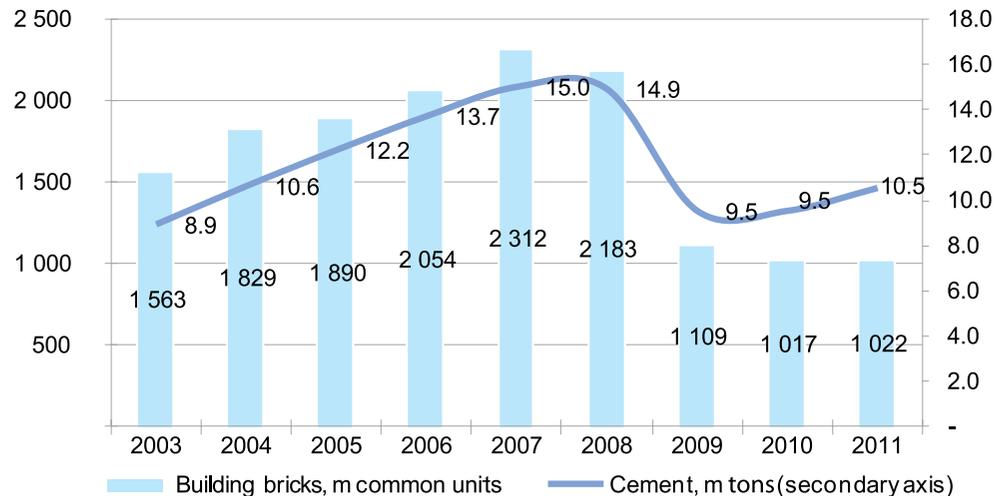
Source: DTZ Research, Colliers International, public sources

4. Overview of building materials market

After decline in 2008-2009 the market of building materials shows signs of revival due to recovery in construction sector as a whole and realization of various infrastructure projects due to preparation for European Football Championship, in particular.

In 2011 production of cement in Ukraine increased by 10.7% corresponding with growth in construction sector. If growth dynamics in production of cement continues the sector could reach pre-crisis level in 2-3 years.

Dynamics of construction materials production



Source: Ukrstat

According to research of Personal Analytical Unit 88% of the cement market of Ukraine is under control of foreign groups: Eurocement, HeidelbergCement, Lafarge, CRH, Buzzi Unicem – Dyckerhoff. In order to improve competitiveness of its cement units, the groups are heavily investing in modernization and expansion of production (investments in the cement sector equals EUR150-200 m annually).

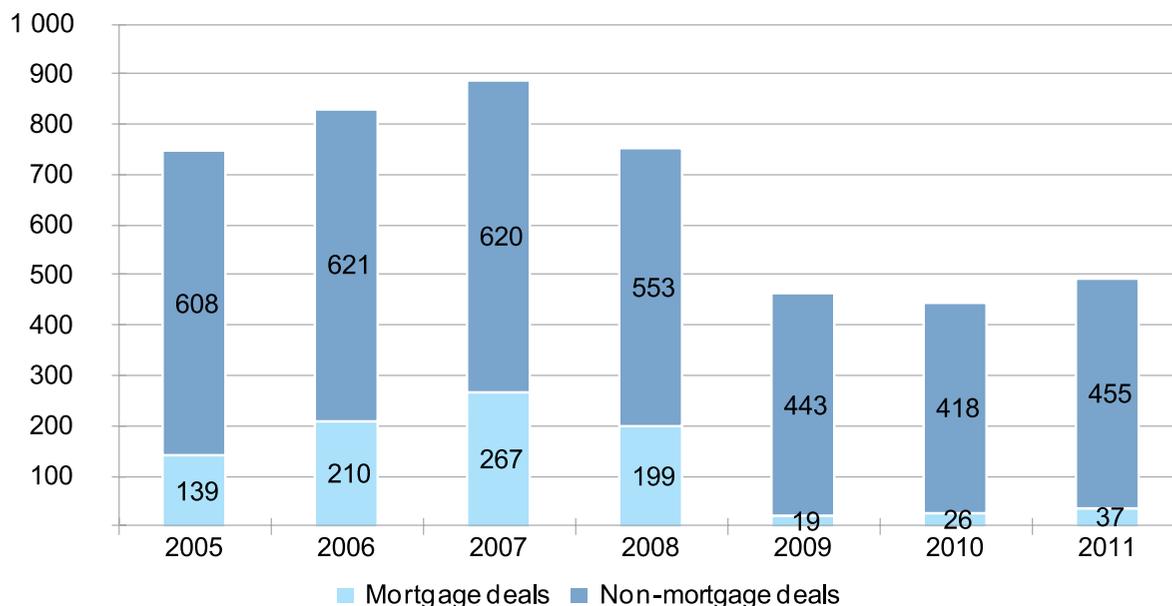
Development of a new segment on the market is expected to take place. It will be small plants with capacity of 300 thsd tons of cement per year. They will reduce the price of cement products in remote areas through the establishment of a regional network of small facilities.

5. Market risks

Construction in most cases is performed on debt funds. That is why financial crisis of 2008 in banking system had direct impact on construction sector where a lot of companies shrunk and some were on the brink of failure.

At the same time majority of purchases of residential housing were made using personal funds of buyers. After 2008 high interest rates and short maturities of up to 5 years were the basic reasons for the low level of housing loans.

Number of apartments and houses purchase deals, thsd units



Source: Experts league of Ukraine

Improving liquidity in Ukraine's banking system seems to have its positive impact on the real estate market. Decreasing interest rates and increasing loan-to-value ratios indicate some improvements in

terms of financing for borrowers. Besides, new types of financing are emerging, such as financing leasing of real estate, for example.

6. Leading players

Kiyv miskbud, T.M.M., Poznyakyzhylbud, Consol, Stolitsa, K.A.N. Development, UDP, Osnova-Solsif are among major players on the market of residential and commercial construction of Ukraine,

TMM

TMM is a vertically integrated real estate developer and construction company of the full scope. TMM has been operating on the Ukrainian market of real estate construction since 1994 and is one of the leading real estate developer and construction companies in Ukraine.

The Company's projects are presented in Kyiv and Kyiv region, Kharkiv, Zhytomyr and the Crimea. As of today the total area of 32 projects completed by

Kyivmiskbud

Holding Company "Kyivmiskbud" was created based on assets of state utility construction corporation Kievgorstroy in 1994. Joint Stock Holding Company "Kyivmiskbud", through its subsidiaries, engages in the businesses of housing, construction, real estate selling, repair and facility management, communication equipment organization, computer technology services, medical services, and hotels.

while Altkom, Azovinteks, Mostobud, Kyivmetrobud are active in industrial construction. Overviews of major players active on the market are presented below.

TMM during 1994-2011 is over 600 thsd m² Current portfolio of 34 projects valued at USD 415 m by CBRE as of end of 2010.

In 2007 TMM entered international equity market. As a result of the placement, TMM attracted USD 105 m and was assessed on USD 800 m by market at the placement date. Revenue for 2010 totaled USD 51 m.

In 2011 Kyivmiskbud as a customer and contractor in the operation completed 213 thsd m² of residential housing or 2,799 units of apartments, which is about 15% of the total housing construction in Kyiv. Being a general contractor of reconstruction of The National Sports Complex "Olimpiyskiy", which hosted the final of the European Football Championship Euro-2012, the Company finished the stadium in 2011 as well. The revenue of the Holding Company equaled around USD 250 m for the period.

Altcom

Altcom is a financial industrial group, headquartered in Donetsk and represented in 12 regions of Ukraine as well as overseas. The group is interrelated chain of enterprises, involved in works from extraction, production and conversion of raw materials to accomplished stages of prospecting, designing and building industrial and civil objects and also building of roads with different level of complexity.

Company is a general contractor of a number of objects being constructed in Ukraine for hosting EURO-2012. Among them international airports in Lviv (project cost is USD 293 m) and Donetsk (USD 285 m), stadium in Lviv with 34 thsd spectators' seats (USD 288 m), highway Lviv-Krakovets (length

of 84.4 km, USD 512 m) and other major highways in Ukraine. Altcom actively works on external markets: highways in Romania and a vehicle bridge in Turkmenistan. The Company has also successful experience in construction of residential complexes primarily in Donetsk. In 2010 Altcom put into operation 58 thsd m² of dwellings. As of mid of 2011 Company's backlog of business orders was assessed as USD 2 bn.

Local players prevail on construction market of Ukraine, while international companies dominate on the market of building materials, where 12 out of 15 operating cement plants in the country are under the control of international holdings.

Largest international players on building materials market*

Company	Average sales, USD m	Average sales growth	Average EBITDA, USD m	Average EBITDA margin
Eurocement-Ukraine	211.3	4.4%	82.7	39.1%
Dyckerhoff (Yugcement, Volyn' - Cement)	173.7	(2.8)%	40.7	23.5%
Heidelberg Cement Ukraine	140.3	6.2%	46.5	33.2%
Henkel Bautechnik	138.1	8.4%	50.5	36.6%
CRH - Podilskyi cement	133.3	(7.3)%	38.6	28.9%
Knauf Gypsum Donbas	95.0	37.7%	43.2	45.5%
Lafarge - Mykolaivcement	82.8	0.5%	28.3	34.1%
Ruukki Ukraine	59.0	14.6%	11.9	20.3%

* Average for the period 2006-2010

Source: ISI Emerging Markets

7. Legislation

Licenses, permits, limitations

According to Ukrainian legislation construction is subject to licensing requirements. The licensing body is the State Architectural Inspection of Ukraine (hereinafter referred to as the “SAI”).

Companies responsible for certain types of works/services connected with creation of architectural objects (i.e. preparation of town-planning requirements, working documentation for construction, construction and demolition etc.) should also pass professional evaluation and receive respective qualification certificate.

Due to recent reforms all construction objects are divided into five categories depending on the complexity of the architectural and construction decision and/or engineering equipment.

The order of the construction depends on the above-mentioned categories of complexity. The general order includes the following stages:

1. Obtaining by the client (who orders the construction) basic data (including information on city-planning requirements and limitations, design statement);

Controlling authorities

The central executive body in the field of construction is the Ministry of Regional Development, Construction and Housing and Communal Services of Ukraine (hereinafter referred to as the “MRD”).

2. Elaboration of design documentation and its expertise (if required);
3. Approval of the design documentation;
4. Execution of the preliminary and construction works;
5. Putting into operation the completed construction object;
6. Registration of the property rights on the construction object.

There is simplified procedure based on the construction passport of the development of land for construction of buildings on the homestead, suburban and garden land plots. There are also special simpler requirements for placement of so-called small architectural forms and temporary structures for conducting entrepreneurial activities.

The basic obligatory requirement for construction is compliance with construction regulations, norms and standards.

Additionally state architectural and construction supervision and control is conducted by SAI and its local divisions.

Special regulations

There are several industry-specific laws in this field in Ukraine, namely Laws of Ukraine “On architectural activities”, “On foundations of the city-planning”, “On regulation of city-planning activities”, “On the liability for offences in the field of city-planning activities”.

Taxation/special offers from government

With regards to corporate income tax (hereinafter referred to as the “CIT”) the general taxation rules are applicable. CIT is currently calculated at a flat rate of 21%. CIT rate will be reduced to 19% from 1 January 2013 until 31 December 2013 and to 16% from 1 January 2014 onwards.

Still, there are some peculiarities, including, but not limited to the following:

- Income in the form of contribution, funds and property for exercise of their principal activities gained by housing associations which organize the construction of accommodations is not subject to CIT as housing associations are nonprofit organizations.
- Income in the form of funds obtained from investors of the mutual investment funds/owners of the certificates of the funds of real property business and income on the operations with its assets are not subject to CIT. This rule is applicable for abovementioned organizations established for construction of accommodations.

Beyond this there is a big amount of substatutory legislative acts, including regulations of Cabinet of Ministers of Ukraine, MRD’s orders etc.

With regard to the specific character of the field one also needs to consider legislation of Ukraine in the field of real estate in general and land particularly.

Value added tax (hereinafter referred to as the “VAT”) currently levied at a rate of 20% of the taxable value of domestic supplies, imported goods and auxiliary services. The VAT rate will be reduced to 17% from 1 January 2014.

With regards to the field in focus one of the peculiarities to be noted is that only first supply of accommodations is subject to VAT, next supplies are exempt.

Recent construction reforms in Ukraine have caused active development of the relevant legislation. Subsequently the main trend in the construction field is simplifying construction procedures and development of new legislative acts to comply with recent changes (i.e. development of new licensing terms for conducting construction).

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