CUSHMAN & WAKEFIELD | #MARKETBEAT

2018

Commercial Real Estate - Russia

#MARKETBEAT

Cushman & Wakefield Research Department

Q4

- Macroreview
- Capital Markets
- Office
- Retail
- Warehouse & Industrial
- Hospitality & Tourism

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Outlook

GROWING DISPARITY IS THE MAIN CHALLENGE FOR THE ECONOMY AND THE COUNTRY'S DEVELOPMENT IN THE COMING YEARS.

Disparity will grow both in the social sphere and in business: the gap between losers and leaders will widen even within one industry.

BRIEFING: STAGNATION AND INFLATION

2019 will be troubling for the Russian market. It will grapple with two developments: on the one hand - inflation of expenses, the cost of goods and its supply chain. At the same time - a limited growth in administrative and market-driven costs. Under these conditions a strategy of restraint may be the most realistic, however inflationary pressures will begin to gain momentum.

The real estate sector ended 2018 positively. The volume of annual transactions in the office market reached 2 mn sq. m, a historical record. The average rental rate for a Moscow office grew by 2.3% in real terms. Meanwhile the rate for a central office grew in real terms by 13%, but rates for those outside the Third Transport Ring fell by 3%. Thus the gap between expensive and cheap real estate widens.

The government has formulated a strategy for the coming years – the promotion of stability through financial control and the realization of national projects.

Residential and infrastructure developments are considered the main drivers of economic growth. The growth of the retail sector remains minimal, indicating the end of the consuming boom.

A lack of economic growth generally points to the need for a large scale reallocation of different industries' contribution to the economy. In line with the predictions from government leaders, growth will be from construction, the financial sector and manufacturing. The retail sector, education and medicine will grow unabated.

In the real estate sector the widening gap will continue to grow between the market leaders and those of the second tier. Market leaders will find it harder to maintain their superior status, and attractive locations will not guarantee success given significant change to the current status quo of the city, the growing population density of the peripheries and generational transition.

Trends of 2019:

- Increasing tax burden and inflation of costs
- Stagnation in the retail market
- Growth of the key rate
- Threat of overheating in the construction sector
- First step in the program of renovation
- National housing project and transition to project financing

Section 1

MACROREVIEW

- Stagnation in the economy and structural changes in the country.
- Consumer credits and residential construction are defined by the government as the main drivers of economical growth.

MACRO INDICATORS

	2017	2018	2019	2020	2021
GDP growth, %	1.6	1.65	1.37	1.63	1.52
RUB/USD	58.3	62.66	65.3	63.9	63.1
CPI, %	3.7	2.9	5.2	4.3	3.8
GDP deflator,%	7.6	9.6	6.4	5.1	4.2
Interest rate, %	10.55	9.0	10.0	10.6	9.5
Current Balance, % of GDP	1.5	1.8	1.6	1.1	-0.1
Private consumption, %	3.3	2.17	1.0	1.94	2.28
Government spending	0.4	0.17	0.6	0.9	0.9
Capital outflow, bn USD	12.28	-37	-89	-100	-95
Unemployment rate, %	5.20	4.8	4.7	4.6	4.6
BRENT crude oil price	54.2	71.1	61.4	65.6	66.8

Source: Oxford Economics 14/01/2019

2018 IS THE BEST YEAR OF THE PREVIOUS FIVE

After good results in 2018 growth will slow down.

1.8 %

GDP Growth for 2018

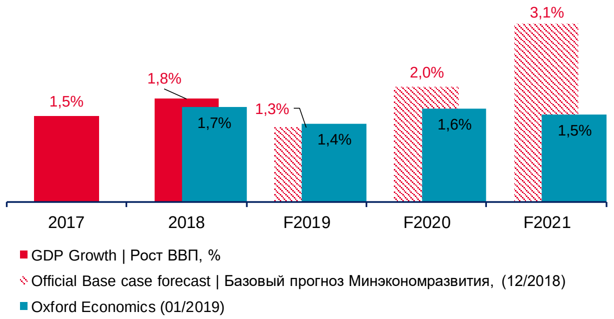
Oxford Economics

5.5 %

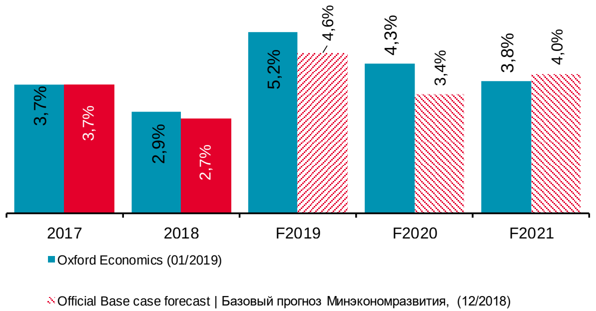
CPI target

By the Central Bank

GDP Growth, %



The Consumer Price Index, %



A review of the key macro indicators for 2019 reveals the pessimism of the Russian government regarding the near future. Pressure from tightening sanctions and accelerated inflation will be the main challenges for the government in 2019.

Additionally, 2019 will see a rise in VAT to 20%, and a further development of the pension reform.

Yet of particular concern will be the government's push for 'De-dollarization'. Bearing in mind the de-facto pricing strategy of B2C that has been transferred to the Ruble zone, it follows that the government wants to regulate relations between legal entities. Taking into account the GDP deflator predictions for this year of more than 10%, the role of this 'De-dollarization' in capping the producer price index is of particular significance.

CONSUMER CREDIT BOOMING AND INCOME STAGNATION

The growth rate of household debt reached an all-time high in 2018. For 11 months aggregated household debt grew by 21% and reached 250,000 RUB for the average Russian household.

23 %

Growth of Mortgage Households' Debt

Jan-Nov 2018

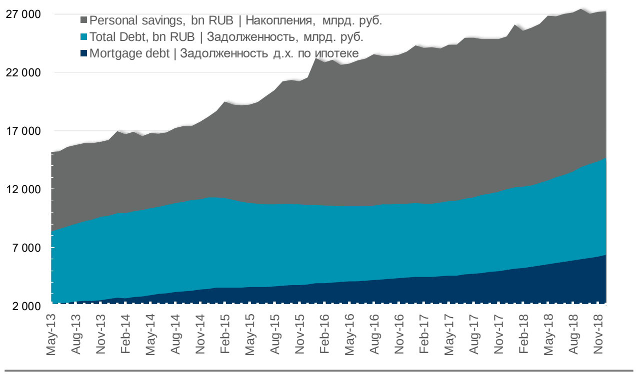
6 %

Share in GDP

Of the mortgage debt in Russia

Source: Central Bank, Cushman & Wakefield calculations

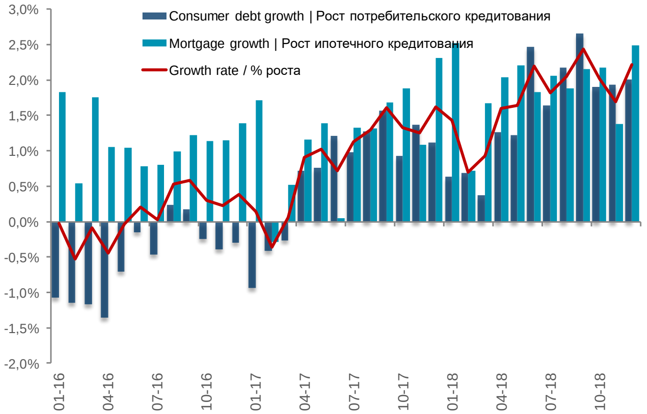
Shares and deposits (of physical persons), bn RUB



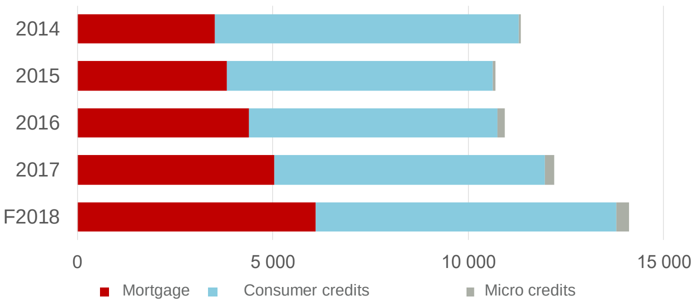
Despite the high growth rates, the debt-to-GDP ratio to date remains the lowest in Europe. In Eastern Europe, mortgage loans account for 15-20% of GDP, and in Western Europe they are closer to 70-100%.

High mortgage growth rates at a time of high interest rates indicate that consumer spending will be limited, due to a large share of household income being used to pay off credits.

Growth Rate of Household Debt



Household debt structure, bn RUB



THE ECONOMICS OF LENDING - A DRY SPELL

At the end of 2018 lending dried up. The increase in the key rate will hamper lending in general, however the transition of residential construction to project financing will probably lift the construction sector out of its stagnation which it has found itself in since 2015.

7.75 %

Key Rate

Increased by 0,25 in Dec 2018

23 %

Overdue Debt

In Real Estate sector

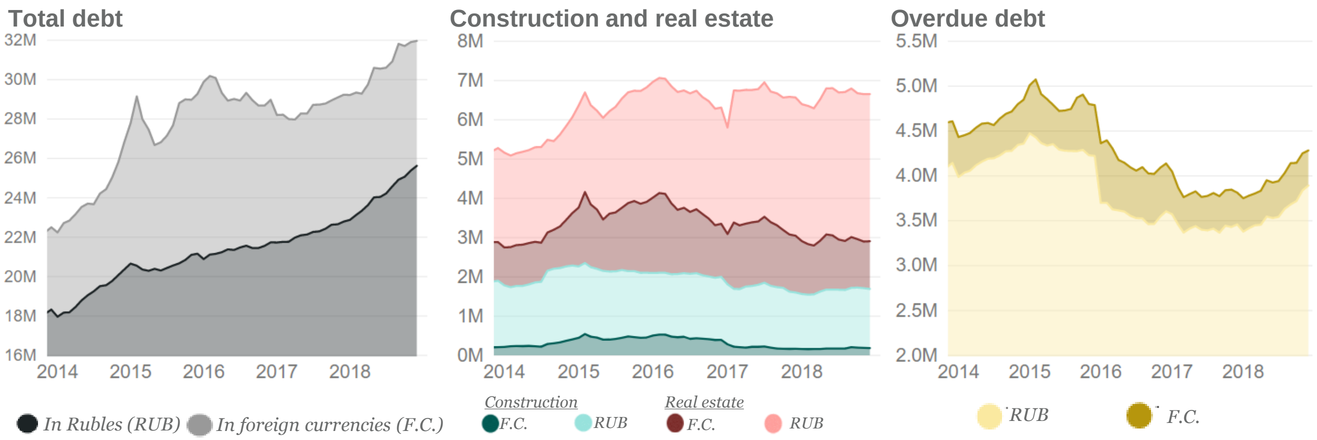
Power BI

Source: The Central Bank of Russia

The end of 2018 saw an accelerated growth of credits in retail. This indicates that at the start of this year, retail sales will be relatively stable. It is likely that the compression of the retail sector will recommence in the second quarter of 2019.

The debt of companies, dealing with real estate and construction, has not grown since 2015. The rate of debt in these sectors remains high: 23% for those in real estate and 18% in construction. However, the shift of residential construction to project financing will become the stimulus for the growth of credit-driven development in 2019-2020.

Corporate debt and overdue debt, mn RUB



PUBLIC RETAIL AND DEVELOPMENT COMPANIES

Stock Market Indicators from 18/10/18 to 15/01/2019 as compared to the MICEX index

Stock prices MICEX index

+9.5 %

Magnit

The growth leader over the past 90 days

-31.1 %

LSR Group

The largest fall for the period of 90 days

Source: MICEX, Yahoo Finance

Lenta

Magnit

M.video

PIK

Sistema Hals

LSR Group

Section 2

CAPITAL MARKETS

- Foreign capital outflow stopped in 2018.
- Investment market compression in 2018 will cause a growth of the capital rates.
- In 2019 the market growth will be driven by the interest of local investors

1.6 bn EUR

Total investment volume in Russia

In 2018

2.5 bn EUR

Total investment volume in Russia

Forecast for 2019

9.5 %

Capitalization rate, prime office segment

January 2019

-6 mn EUR

Foreign investments outflow

In 2018

Capital Markets

IN 2018 THE OUTFLOW OF FOREIGN INVESTMENT CEASED.

We expect investment activity to increase in 2019-2020.

EASTERN EUROPEAN INVESTMENT IN COMMERCIAL REAL ESTATE

Poland retains its position as the strongest investment market in the region. In 2018, Poland's share of the total recorded investments accounted for 52% of all investments in commercial real estate across Eastern Europe.

10%

The share of Russia in CEE

By the total investment in commercial real estate

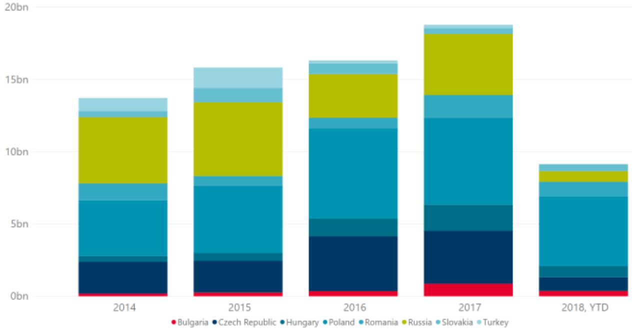
6.3 bn EUR

Investment volume in Poland

The largest investment market in CEE region since 2016

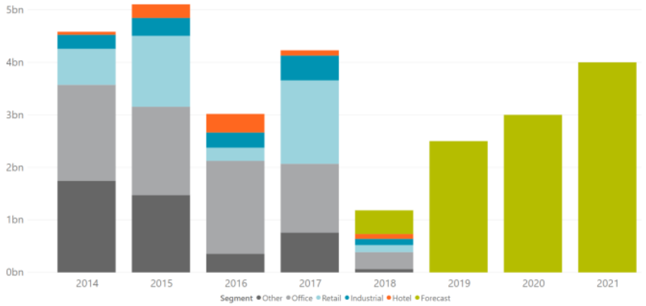
Source: Real Capital Analytics

Investments in the core CEE markets, bn EUR



Poland maintained a leading position in the regional investment market, covering more than a half of the total. In 2018, only Poland and Slovakia showed higher levels of investment activity compared to the previous year. Russia showed minimal investment volumes which are lower than in the Czech Republic.

Investments in Russia, bn EUR



The Russian investment market is in its weakest position to date in the history of the real estate market. The last time we registered lower levels was before 2006. Between then and 2018, the volumes never fell that low.

The exit of foreign investment from the Russian market is complete. The inflow and outflow of foreign capital in 2018 are almost equal (about 210 mn EUR) while the outflow was 800 mn EUR more than the inflow in 2017.

CAPITALIZATION RATES

9.25 %

Office

Capitalization rate, Jan 18

7.75 %

The key rate

The Central Bank of Russia

«

In 2019 the key rate will drive the market. It is not likely that we see compression of cap rates due to the investment market shrinkage in 2018 while decompression will not exceed 50-75 b.p.

»

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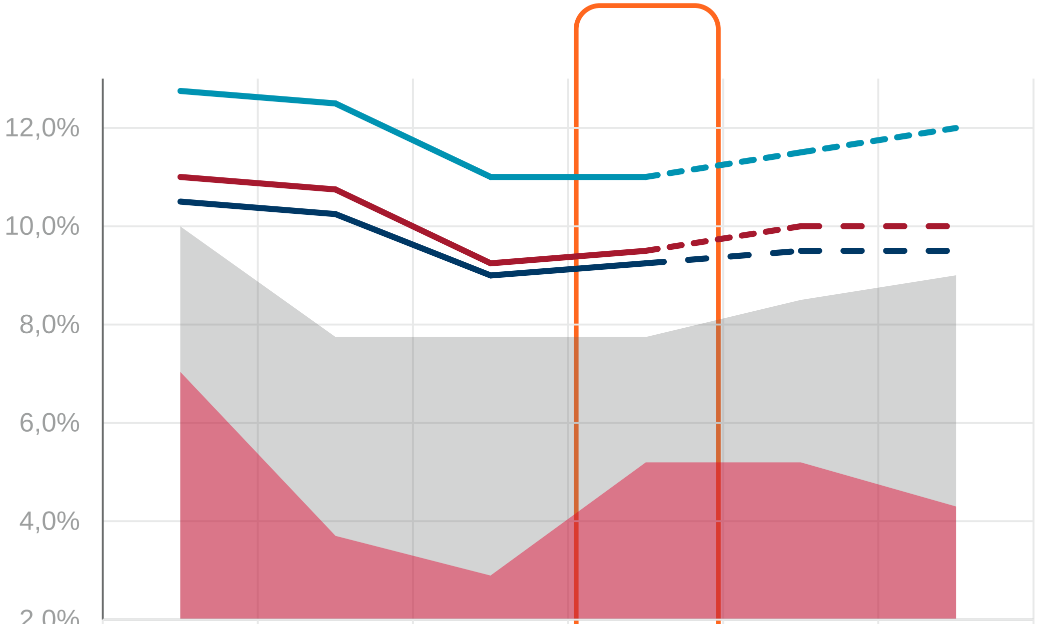


	2016Y	2017Y	2018Y	Q1 2019	2019F	2020F
Central Bank Key Rate	10,00%	7,75%	7,75%	7,75%	8,50%	9,00%
Inflation	7,04%	3,70%	2,90%	5,20%	5,20%	4,30%
Office	10,50%	10,25%	9,00%	9,25%	9,50%	9,50%
Shopping Centers	11,00%	10,75%	9,25%	9,50%	10,00%	10,00%
Warehouse	12,75%	12,50%	11,00%	11,00%	11,50%	12,00%

Capital Markets

INVESTMENT STRUCTURE

Foreign investment continues to account for a relatively small share of the Russian market. This situation is expected to remain unchanged in the upcoming years.

69 %

The share of foreign investments

The Central and Eastern Europe, 2018

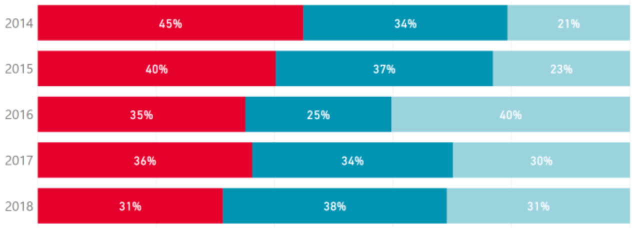
14%

The share of foreign investments

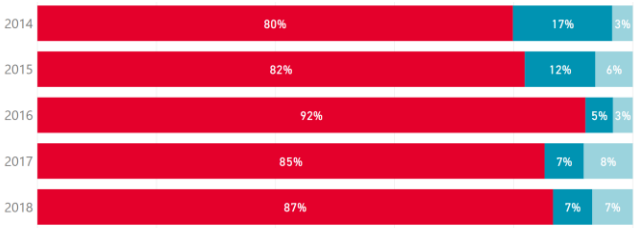
Russia, 2018

Source: Real Capital Analytics

Central and Eastern Europe



Russia



Domestic External, Europe External, Other

Investments in Eastern Europe are relatively evenly distributed, with similarly-sized shares originating from within the domestic market, as well as from both regional (European) and external sources (The United States, Asia, Africa etc.). In 2018, the share of Non-European investments increased. From a broader perspective, as the market continues to open itself up to new participants, it is the external investment market that shows the most positive signs of growth.

The Russian market continues to be dominated by domestic investors. This situation has been observed since 2009, whereas prior to 2009, particularly between the years of 2004 and 2007, European investors represented the majority of market players.

We predict that the share of international investment in the Russian market in the upcoming years will not exceed 20%, until the market becomes more open to international capital.

Section 2

OFFICES

- According to our forecasts, all the indicators of the office sector showed a slight improvement.
- 2018 became a record year:
  - ✓ A historically high take-up was recorded. Tenants welcomed the new opportunities.
  - ✓ New construction reached a historic low in the last 15 years.

Moscow 2018

Classes A, B+ & B-

17.24 mn sq. m

Total stock of office buildings

133 ‘000 sq. m

Construction

415 ‘000 sq. m

Net absorption

2 mn sq. m

Take-up

Offices

A NEW REALITY FOR THE OFFICE SECTOR

The new market conjecture indicates a period of lower new construction, minor positive absorption and a moderate increase in rental rates at the indexation level. In real terms, rental rates will be stable.

NEW SUPPLY

The market has recorded a 15-year minimum for the delivery of new office space. In the coming years, the pace of construction will be stable.

133
'000 sq. m

New construction

In 2018

150
'000 sq. m

New construction

In 2019F

Source: Cushman & Wakefield

The record for the low volume of construction exceeded expectations. Instead of the planned 200,000 sq. m, in 2018 new construction amounted to only 133,000 sq. m.

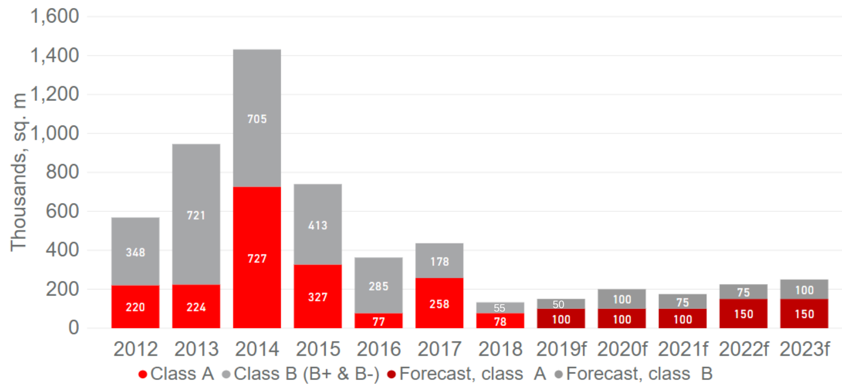
In Q4 2018 the only office building delivered into the market was Amal'teya business center (class A). Thus, new construction of Q4 amounted to 31,000 sq. m.

Construction activity was distributed throughout the city - approximately the same volume of construction was built in the traditional business areas in the city center and outside the TTR.

Office rentable area of the majority of new buildings does not exceed 20,000 sq. m. There were exceptions: Novion business center and Amal'teya business center (22,000 and 31,000 sq. m, respectively).

Although 400,000 sq. m have been promised, according to our estimations, new construction will be lower (150,000 – 200,000 sq. m). Iskra Park will be the largest property of class A (50,000 sq. m of office rentable area). New buildings will be evenly distributed in Moscow, while the biggest of them will be built outside the TTR.

New construction, class A and B



DEMAND

2018 has broken the historical record by take-up. By the end of the year, increase in tenant activity was traditionally observed.

2

mn sq. m

Take-up (lease and sale deals)

In 2018

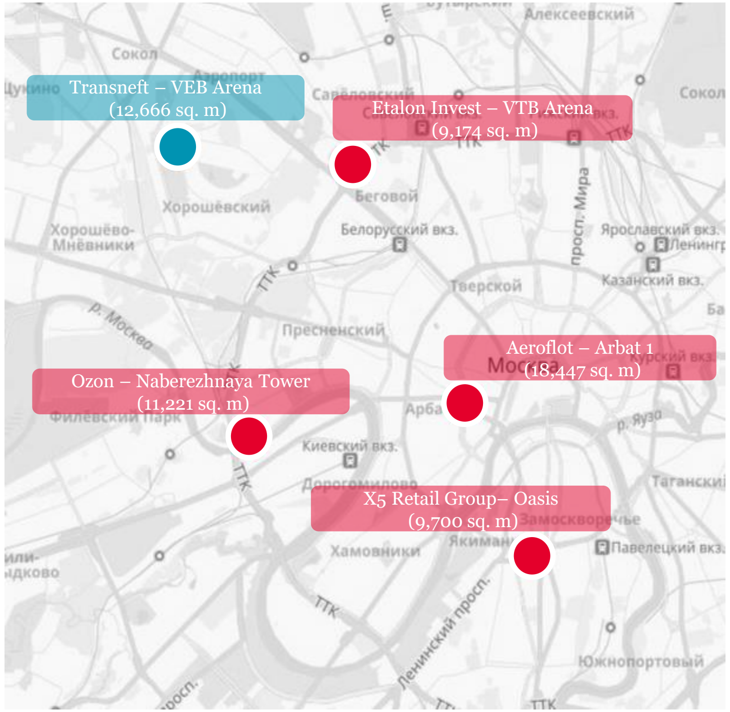
1.8

mn sq. m

Take-up (lease and sale deals)

In 2019F

Major deals in 2018



Class A   Class B (B+&B-)

In Q4, take-up amounted to 640,000 sq. m. Class A continues to grow moderately. A considerable leap in demand occurred due to the increase in demand in class B.

The most active industries in 2018 by number of deals were Banks and Finance (12%), IT and Computers (9%) and Retail (8%).

The main demand according to the closed deals relates to blocks of less than 2,000 sq. m and only 30% of demand accounted for bigger blocks. We are registering a local shortage in large consolidated blocks in the central area.

We expect a slight decline in demand in 2019 - 2020 due to the government’s decisions to increase the tax burden on business, conservative forecasts of the economy and new cycle in the office real estate market. Nevertheless, the figure will remain at a natural level for the market – 1.6-1.8 mn sq. m. In the medium term, by 2022, demand will again reach the level of 2017 - 2018.

STABLE POSITIVE ABSORPTION

During 2018, the best quality premises were taken off the market.

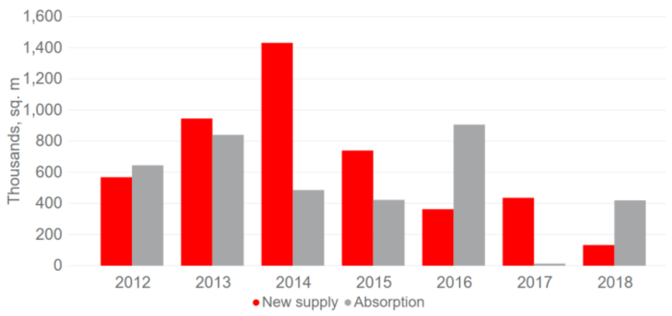
In 2019, tenants are unlikely to reduce their office area, thus, against the background of low construction activity and stable high demand, net absorption will remain positive.

415

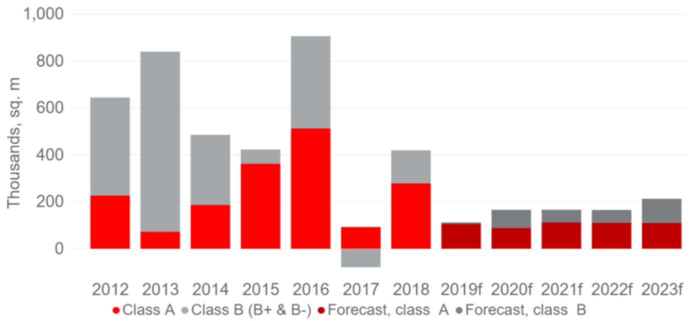
'000 sq. m

Absorption in 2018

Absorption and new construction



Absorption by class



Absorption is an indicator that reflects the difference between the area occupied at the beginning and at the end of the period. *Positive absorption* means that additional vacant office premises are "selected" from the market. *Negative absorption* reflects the opposite - the release of additional office space, which together with new construction leads to vacancy.

Source: Cushman & Wakefield

VACANT OFFICE PREMISES

Against the background of record high demand and low new construction, the vacancy rate decreased by 1.8 percentage points since the end of 2017 and amounted to 10.4% in Q4 2018. In the coming years, the vacancy rate will remain at the level comparable to 2018.

10.4 %

Vacancy rate by the end of 2018

Classes A and B (B+ & B-)

1.85 mn sq. m

Vacant premises, January 2019

Classes A and B (B+ & B-)

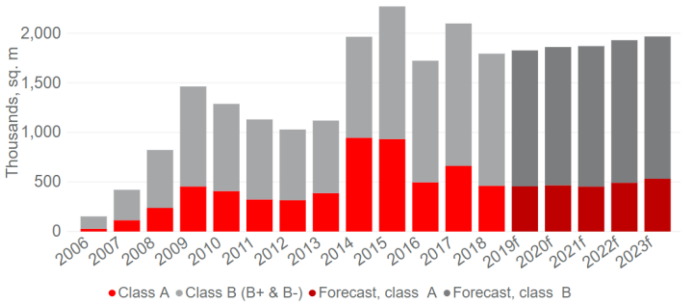
Source: Cushman & Wakefield

Vacancy rates

The tendency of reducing vacancy rate, which began in 2017, was observed throughout the year. At the end of 2018, the vacancy rate amounted to 10.4%. This decrease occurred mainly due to a decrease in vacancy in class A outside the Garden Ring. While in the historical center of Moscow the vacancy rate is gradually increasing.

Beginning from 2015, the vacancy rate in class A is gradually decreasing from the first quarter to the last, generally decreasing over the past 4 years at a similar pace. In class B, the vacancy rate has been stable for the last 2 years.

Vacant premises

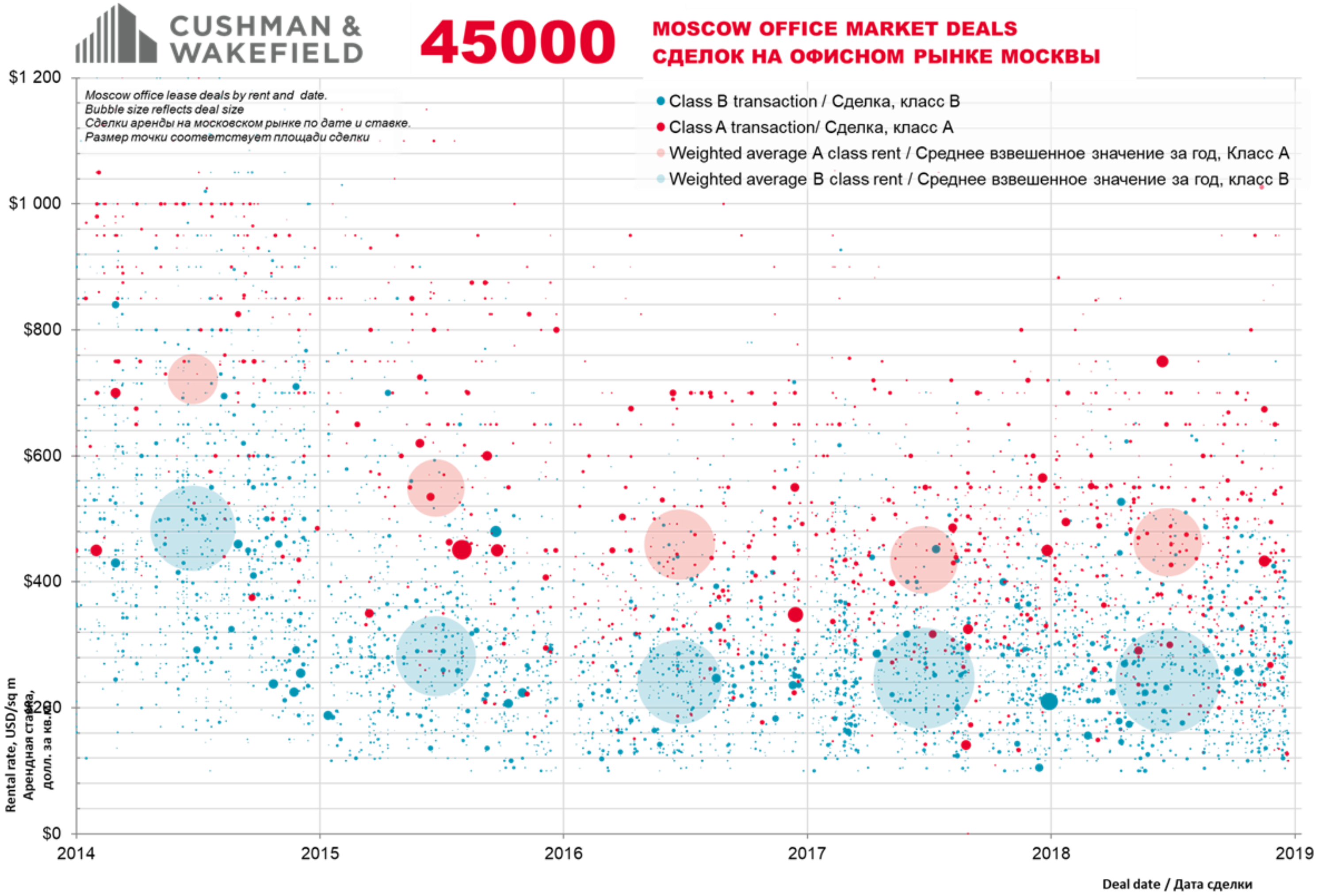


In 2018, the Center and the West were most popular when choosing an office. The vacancy rate in Moscow decreased due to high demand for premises in such submarkets as: Central Business District, City, South -West and North -West. The most significant decrease in vacancy rate occurred in Kutuzovsky, Belarussky and Basmanny.

Due to the lack of big vacant blocks in the center, tenants pay more attention to the locatios between the TTR and the MKAD.

LEASE DEALS IN MOSCOW

Moscow office lease deals by rent and date. Bubble size reflects deal size.



RENTAL RATES

Rental rates keep on growing. In 2018, the rental rates for office premises in Moscow increased by 5% compared to 2017 on average. Rising prices for class A in the center of Moscow within the Garden Ring had a great impact on growth.

264

USD / sq. m annum

January 2019

Dollar equivalent (all deals in classes A and B)

17,635

RUB / sq. m annum

January 2019

Ruble equivalent (all deals in classes A and B)

Source: Cushman & Wakefield

Leasing demand and rental rates

Class	Deal currency	Deals volume, sq. m	Rate
A	USD	162,033	$605
	RUB	386,179	24,657 rubles
B+ & B-	USD	13,730	$494
	RUB	1,330,579	14,847 rubles

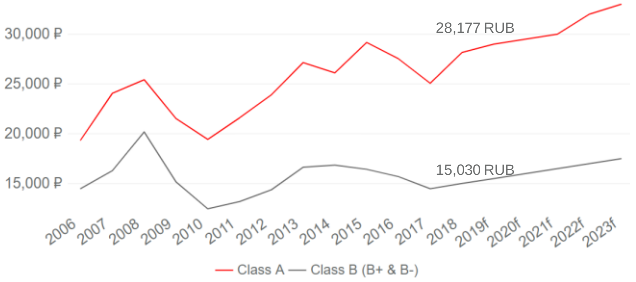
8.8% - share of USD deals (all lease and sale deals)

The average dollar equivalent of rental rates in Class A (the end of 2018) is 454 USD/ sq. m/year (28,177 Rubles/ sq. m/year). The average dollar equivalent of rental rates in Class B is 15,030 Rubles/ sq. m/year (238 USD/ sq. m/year).

In the coming years the average rental rate will continue to grow by 4-6% per year.

Rental rates in US dollars

Rental rates in Russian rubles



Section 2

RETAIL

- The consumer market revival was not long-lived. In 2018, consumers returned to the shops but by the end of the year consumer expectations were down. In 2019, the retail sector will be under pressure. Stagnation is expected in the mid-term.
- Due to increased competition and a weak consumer market, the retail real estate market remains sensitive to new retail schemes. Recently opened and renovated properties increase occupancy relatively quickly while tenant rotation is registered in outdated schemes, some of them show growing vacancy rate.

5.2 mn sq. m

Total quality stock in Moscow

In quality shopping centers, mixed-use buildings, outlets, and retail parks

108 ‘000 sq. m

New construction, Moscow, 2018

Retail properties with GLA of more than 15,000 sq. m

8.8 %

Vacancy rate

Quality shopping centers, Moscow

165 ‘000 RUB / sq. m

Prime rental rate indicator

Base asking rental rate for a 100 sq. m gallery unit on the ground floor of a prime shopping center

CONSUMER MARKET IN STAGNATION

After a jump in 2018, the consumer market will stay under pressure due to growing prices and limited income growth in 2019-2020. The preliminary estimation of personal income growth in 2018 from The Ministry of Economic Development looks exaggerated compared to alternative opinions that are much more conservative.

Forecast for 2018

2.9%

Retail sales growth

1.7% - Forecast for 2019

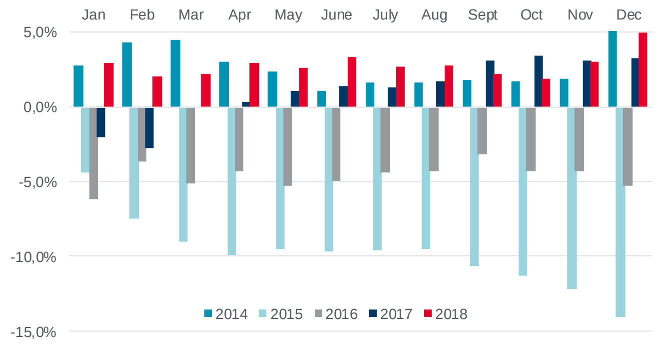
3.4%

Real disposable income

1.0% - Forecast for 2019

Source: The Ministry of Economic Development, December 2018, Rosstat

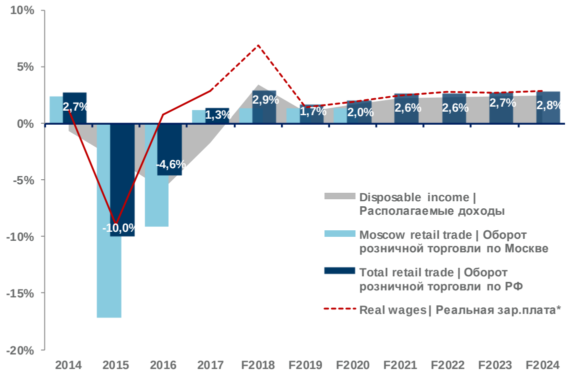
Retail Turnover in Russia



** Monthly change compared to the same period of the last year*

In Jan-Nov 2018 retail turnover grew by 2.6% compared to the same period of the previous year. Preliminary estimation of the annual result from The Ministry of Economic Development looks exaggerated (2.9%). A growth of the retail sector is mostly driven by booming consumer credits.

Consumer Market



The Court of Auditors and the Higher School of Economics estimate the growth of personal income in 2018 at not more than 1%. That opinion is supported by the data from Rosstat – 0.4% in Jan-Nov 2018. The position of The Ministry of Economic Development (3.4%) is most likely driven by political, not economical factors. In 2019, personal income growth will stay at minimum levels which will be one of the reasons for footfall and average purchase size decrease.

PHYSICAL VS E-COMMERCE

Online is one of the drivers for retail segment growth, especially for some goods' categories. But currently the share of online retail in the total turnover is insignificant and provides qualitative growth, but not quantitative.

Share of online in other countries

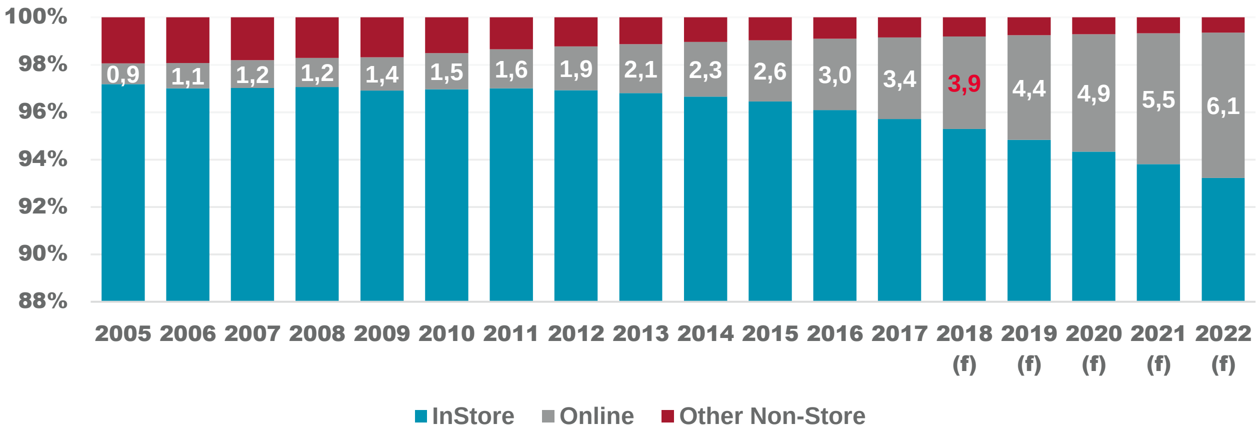
18%
United Kingdom

10%
France

~5%
Central and Eastern Europe

Source: Global Data, Cushman & Wakefield

The share of online retail in the total retail turnover in Russia



People will continue to shop in the traditional sense, but there is no doubt that parts of the European retail market will face growing challenges and a shakeout of weaker centers/formats is a possibility. One of the key drivers of this change is the growth of online shopping. The more mature retail markets of North Western Europe are most at risk of disruption in the short to medium term (online sales cover 10-20% of the total), while in Southern and Central & Eastern Europe, including Russia, online sales remain low. Nevertheless, retailers need to re-configure their distribution networks to suit the omni-channel world.

Retail

THE GAP BETWEEN MARKET LEADERS AND THE REST WIDENS

Under a backdrop of limited resources and income stagnation, increasingly savvy consumers will visit only the top performing retail schemes offering value for money.

SLIGHT INCREASE OF CONSTRUCTION VOLUME IN 2019

A slight increase of construction activity is expected in 2019 after record low figures of 2018. Mostly, it will be provided by opening large-scale projects in Moscow and Moscow region.

483

'000 sq. m

New construction, 2018

Russia (including Moscow)

700

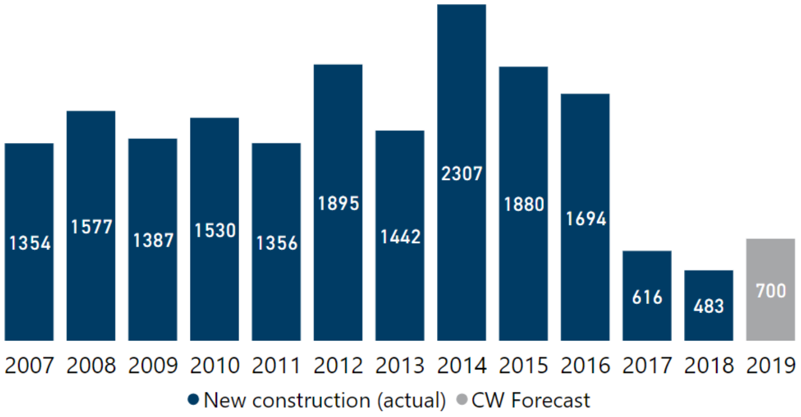
'000 sq. m

New construction, 2019F

Russia (including Moscow)

Source: Cushman & Wakefield

New construction in Russia (including Moscow), '000 sq. m



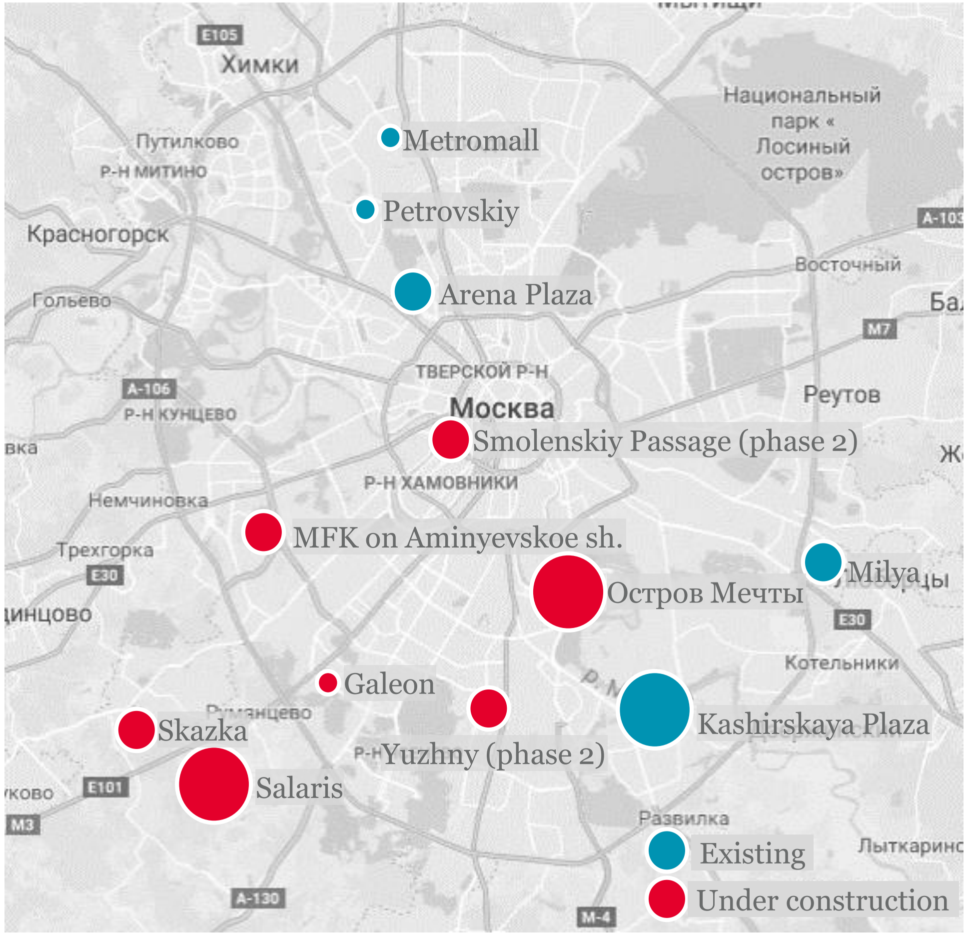
Source: Cushman & Wakefield

Traditionally, the majority of new retail schemes were delivered to the market in Q4 - 10 shopping centers with total GLA of 219,000 sq. m were opened in Russia, which is almost the half of annual construction volume.

The first outlet outside Moscow and St. Petersburg was opened in Ekaterinburg – Brands' Stories (GLA 10,000 sq. m). The development of outlet format will be one of the trends for the next 2-3 years. Two more schemes were announced for completion in Moscow and in other cities.

Less than half of the space planned for delivery to the market in 2019 is located in the regions. Small and medium sized shopping centers (GLA less than 45,000 sq. m) will be opened. A significant proportion of new space will be constructed in Moscow and the Moscow region. In other large and small cities construction activity is spread almost equally – 52% of retail space announced for delivery is located in the cities with a population less than 500,000.

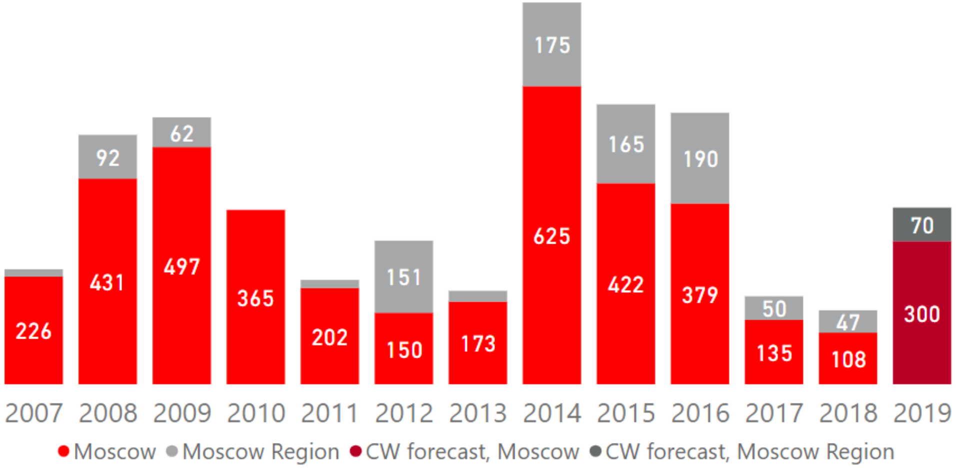
Shopping centers opened in 2018 and planned for delivery in 2019 in Moscow



Retail

NEW CONSTRUCTION IN MOSCOW

New construction in Moscow and Moscow region, '000 sq. m



After record low construction volume in 2018, we expect construction activity to grow significantly in 2019. The growth will be mostly covered by the opening of large-scale projects – Salaris (GLA 105,000 sq. m) and the retail part of Ostrov Mechty entertainment park (GLA 70,000 sq. m).

Salaris and Skazka (GLA 18,000 sq. m) in Rasskazovka will be the first stage of development of retail part within large transport hubs. Several more projects are planned for delivery in 2020-2021.

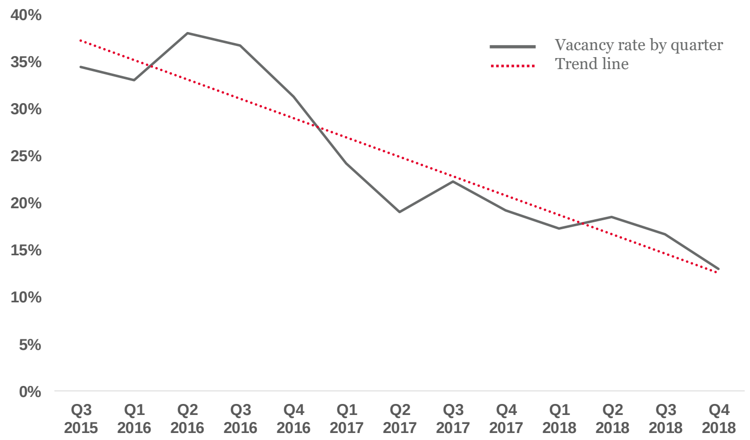
Shopping centers opened in 2015-2018

Retail

VACANCY RATE IS DECREASING IN NEW PROPERTIES

Shopping centers that were opened after 2014 with a high vacancy rate have significantly reduced the vacancy. At the same time, in stabilized shopping centers opened several years ago and earlier we see the rotation of tenants. New properties gradually draw attention of consumers and retailers.

By the end of 2018, the average vacancy rate was 8.8%. The average annual value was 9.2%. If all announced projects are delivered in 2019, the vacancy rate will remain at the level of 2018 – 9-9.5%.



RETAILERS: RESULTS OF 2018 AND TRENDS FOR 2019

In the context of a weak consumer market, retailers will focus on strengthening their existing positions. We expect changes in quality rather than quantitative growth. In order to attract consumers, operators will try new formats, concepts, and communication channels.

DEVELOPMENT PLANS IN 2019

NEW RETAILERS IN 2018

Expansion of target audience via new or hybrid formats and attraction of additional traffic

For example, at the end of 2018, Lamoda online retailer launched the first offline store opened in Atrium shopping center. Retailers often experiment with hybrid formats and collaborations with F&B operators. MTS and Beeline telecom operators announced the opening of Costa Coffee in locations with the highest consumer footfall. Magnit is testing a new concept of eat&go cafes within stores, now the retailer plans to expand the experience to all the regions of presence.

Mergers and acquisitions, business consolidation

Last year, a number of large M&A deals were announced by major local and federal chains (M.Video/Eldorado and Media Markt, Euroset and Svyaznoy, X5 and Polushka, Billa and Ya Lyubimy, Leroy Merlin and K-Rauta and others). The beginning of this year was already marked by the announcement of merger of three large companies – Diksi, Krasnoe & Beloe and Bristol. In 2019, we will see other deals. Market giants occupy new market niches – for instance, Ozon is now selling medication and plans to launch food delivery.

Entry to the new markets – both physical and virtual

In 2018, many Russian retailers announced expansion to the markets of CIS, Europe, America and Asia (Dodo Pizza, Teremok, Detsky Mir, Black Star Burger, Uryuk). First Russian companies will start to sell their goods via Tmall online platform (Alibaba Group). Retailers are developing their own online operations. Additionally, plans for the creation of online aggregators announced last year will be actively developing in 2019.

COMMERCIAL TERMS

In general, commercial terms remained at the same level as last year. The prime segment shows moderate growth.

165 '000

RUB / sq. m / year

Prime rental rate indicator - base asking rental rate for a 100 sq. m gallery unit on the ground floor of prime shopping centers

12-15 %

of turnover

Average rental payment for an operator in retail gallery

Rental rates in prime shopping centers *

Tenant type	Average rental rate, RUB/ sq. m / year	
	Min	Max
Hypermarket	-	8 000
DIY	-	10 000
Entertainment center	-	14 000
Cinema	6 000	12 000
Fashion (anchor)	-	15 000
Retail gallery unit	20 000	250 000
Fitness center	6 500	10 000
Restaurant, café, coffee shop	20 000	150 000
Food court	75 000	170 000

Source: Cushman & Wakefield

*Average rental rates for successful shopping centers in Moscow. The data can be used only for estimation of the level of rental payments.

The most common structure of rental payments is a compound rental rate – either a minimum fixed rent or a percentage of the turnover of the tenant (whichever is higher) is used as a rental payment. "Net" percentage of turnover (without fixed payment) is almost never used as a method of payment, it is sometimes used for large anchor tenants (hypermarkets, entertainment, cinema). However, different payment schemes are used in different shopping centers – in some properties these types of tenants also pay fixed rent.

Average percentages vary from 12% to 15% for retail gallery operators, and from 3% to 7% for large anchor tenants.

Section 2

WAREHOUSE AND INDUSTRIAL

- Record high take up was registered in the Moscow region in 2018.
- Vacancy rate in the Moscow region is decreasing, asking rental rate is growing.
- Developers prefer built-to-suit projects to speculative construction.

MOSCOW, CLASS A

	2018	2019 (forecast)
Stock (‘000 sq. m)	10,558	11,208
New construction (‘000 sq. m)	698	650
Vacancy rate (%)	8,5	7
Rental rate * (RUB / sq. m / year)	3,600	3,800
Take up (‘000 sq. m)	1,770	1,300

REGIONS, CLASS A

	2018	2019 (forecast)
Stock (‘000 sq. m)	6,939	7,419
New construction (‘000 sq. m)	286	480
Take up (‘000 sq. m)	435	450

** Average rent excluding OPEX, utilities and VAT*

DEMAND FOR WAREHOUSE SPACE IS STABLE

Trends. Moscow and Regions

1.1

mn sq. m

New construction, class A and B

Moscow and the regions, 2018

2.45

mn sq. m

Take up, class A and B

Moscow and the regions, 2018

Source: Cushman & Wakefield

2018 showed a record high demand for warehouse space in the Moscow region. Take up reached the maximum figure in the last 10 years – 1.9 mn sq. m. Average deal size hasn't changed since 2017 and comprised 15,000 sq. m, so the take up growth was caused by the increase in the number of transactions.

Vacancy rate is gradually decreasing. We see a lack of large-size warehouse blocks of more than 20,000 sq. m that are ready for lease/sale. However, speculative construction doesn't tend to grow, the majority of warehouses planned for the delivery in 2019 are built-to-suit projects.

In the Moscow region, there is a shortage of land plots for construction of warehouse complexes in the most popular areas (South and North).

In the regions, take up is lower than in Moscow. However, the demand is stable – the volume of transactions decreased just slightly compared to 2017. In 2019, we expect the demand to remain at the level of 2018.

The situation with speculative construction in the regions is the same as in Moscow – developers prefer built-to-suit projects.

In 2018, large-scale warehouse complexes outside of Moscow were delivered in Yaroslavl, Ekaterinburg, Kazan, Ufa, St. Petersburg.

Warehouse & Industrial

MOSCOW REGION

MARKET IS GROWING

In the Moscow region rental rate is growing, vacancy rate is decreasing.

8.5%

Vacancy rate, class A

Q4 2018

3,600

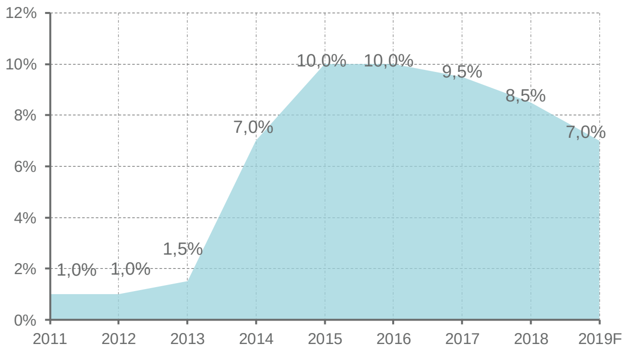
RUB / sq. m / year

Rental rate, class A

Q4 2018

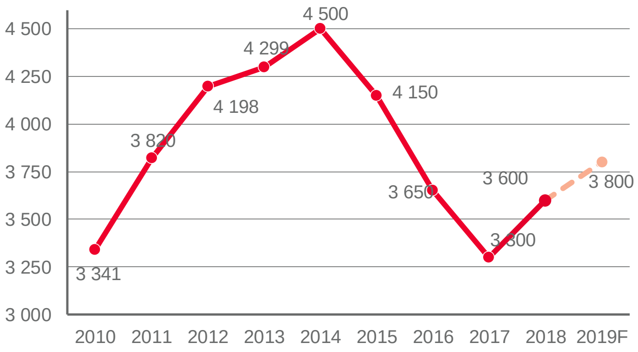
Source: Cushman & Wakefield

Vacancy rate, class A



Against the background of record high take up, we have registered a gradual decrease in vacancy rate throughout 2018. Due to the lack of speculative construction (only 35% of total construction volume in 2019) and stable demand for warehouse premises, we expect this trend to remain the same in 2019.

Rental rate, class A, RUB / sq. m / year



In 2018, the asking rental rate increased by 10% compared to 2017 and is now at the level of 3,600-3,800 RUB per sq. m per year.

If the market conditions remain favorable with high demand and decreasing vacancy rate, further growth of rental rate is possible in 2019.

RECORD HIGH DEMAND FOR WAREHOUSES IN THE MOSCOW REGION

Supply and Demand. Moscow region

787

‘000 sq. m

New construction, class A and B

2018

1.9

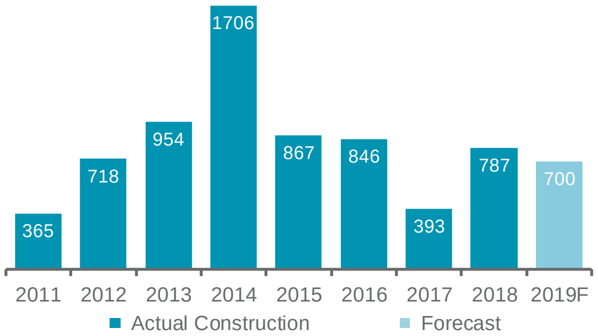
mn sq. m

Take up, class A and B

2018

Source: Cushman & Wakefield

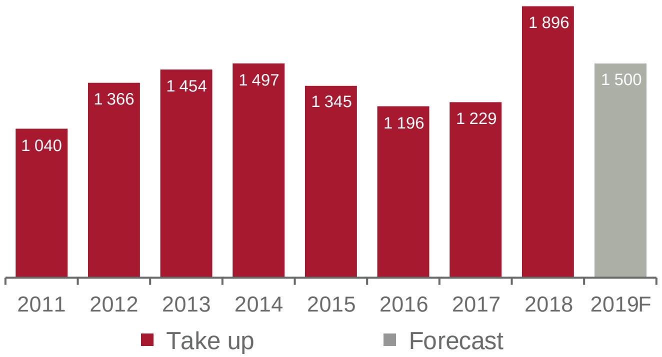
New construction, classes A and B, ‘000 sq. m



In 2018, the supply of warehouse space increased by 787,000 sq. m, which is two times higher than in 2017.

We expect around 700,000 sq. m of warehouse space to be delivered to the market in 2019. Mostly, the new constructions will consist of built-to-suit projects.

Take up, classes A and B, ‘000 sq. m



In 2018, 1.9 mn sq. m of warehouse space was leased and purchased - the highest indicator for the last 10 years.

In 2019, we expect the demand to decrease to the natural market level, take up will comprise around 1.5 mn sq. m of warehouse space.

RETAILERS ARE THE MAIN TENANTS

Demand. Moscow region

43%

Share of retail segment

In the take up structure in 2018

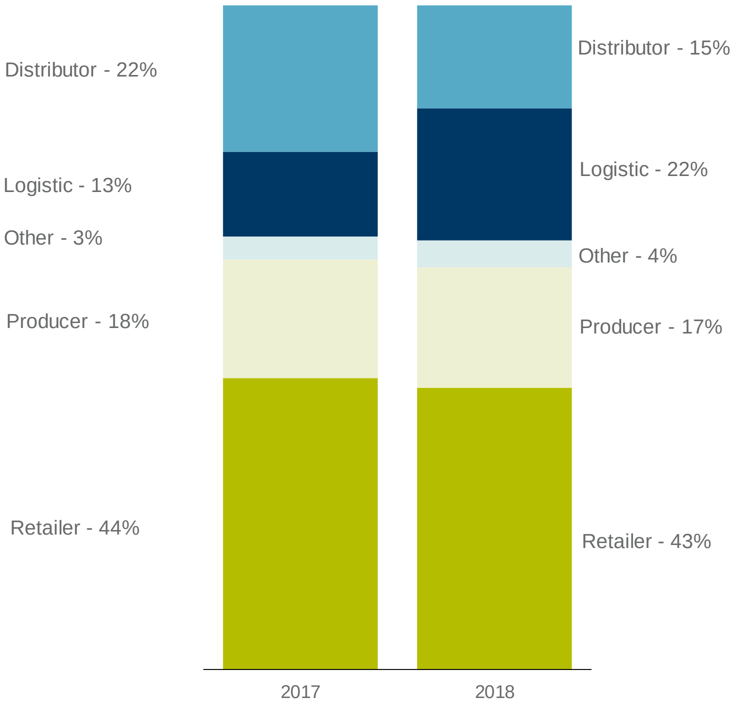
24%

Share of F&B

In the take up structure in 2018

Source: Cushman & Wakefield

Take up structure



Traditionally, the retail segment has had the largest share in take up structure. The average deal size for retail companies was 24,500 sq. m, which is higher than the market average of 15,000 sq. m.

Logistic companies demonstrated the largest increase in demand structure, mainly due to the decrease in the share of distributors.

As of take up structure by profile, F&B has the largest share – 24%.

We don’t expect significant changes in demand structure in 2019.

Warehouse & Industrial

RUSSIAN REGIONS

SEVERAL REGIONS EXPERIENCE LACK OF SUPPLY

Supply and Demand. Regions

301

‘000 sq. m

New construction, class A and B

2018

556

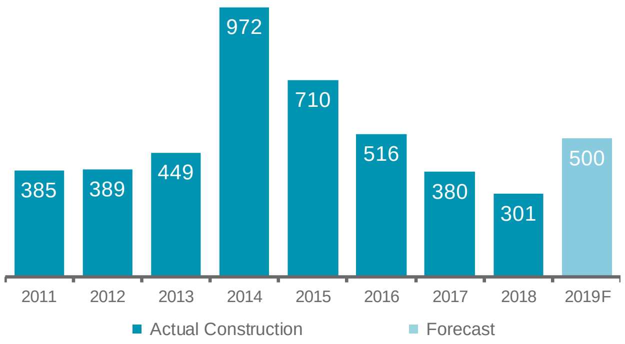
‘000 sq. m

Take up, class A and B

2018

Source: Cushman & Wakefield

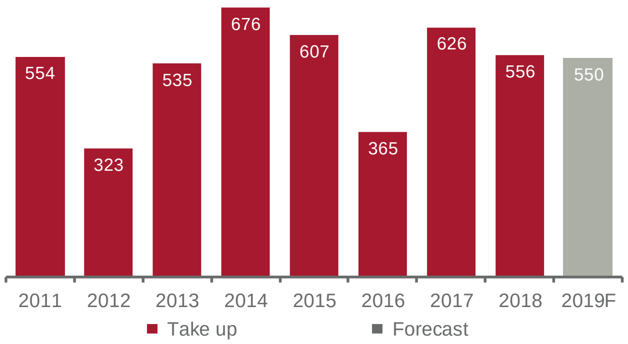
New construction, classes A and B, ‘000 sq. m



In the regions, new construction volume is low – 301,000 sq. m of warehouse space was delivered to the market in 2018. In the regions, the situation is the same as in Moscow – there is a lack of speculative construction.

In response to supply shortage, we will see construction activity growth in several regions next year (Ekaterinburg, Novosibirsk, Rostov-on-Don).

Take up, classes A and B, ‘000 sq. m



In 2018, 556,000 sq. m of warehouse space was leased or purchased. With the same number of transactions compared to 2017, average deal size increased from 7,000 sq. m to 10,000 sq. m.

St. Petersburg has the largest share in take up – 44% of the total transactions volume in the regions.

RETAILERS ARE THE MAIN TENANTS

Demand. Regions

50%

Share of retail segment

In the take up structure in 2018

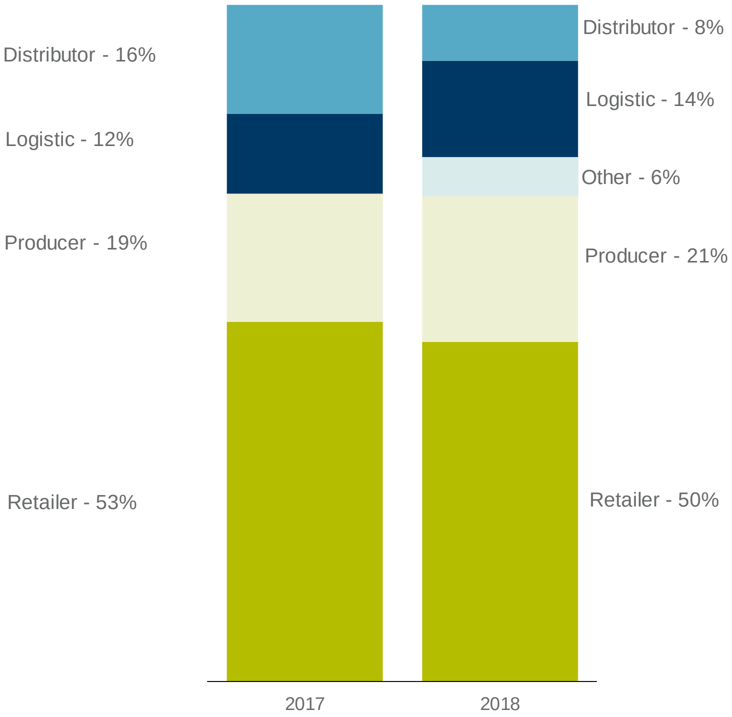
38%

Share of F&B

In the take up structure in 2018

Source: Cushman & Wakefield

Take up structure



About 50% of demand in the regions is still generated by the retail segment.

The demand from distribution companies declined from 16% to 8%.

Regarding take up structure by profile, F&B has the largest share in the total transactions volume– 38%.

We don't expect significant changes in demand structure in 2019.

KEY PROPERTIES

Supply and demand. Moscow and regions

Key warehouse properties delivered in 2018

Property	Region	Total area
Moscow Region		
Auchan DC	Moscow	138,000 sq. m
PNK Park Valischevo	Moscow	97,000 sq. m
Atlant Park	Moscow	77,00 sq. m
Utkonos DC (Orientir Sever-3)	Moscow	68,000 sq. m
PNK Park Bekasovo	Moscow	62,000 sq. m
Logopark Major	Moscow	57,300 sq. m
Kozhuhovo Monarch	Moscow	47,503 sq. m
Vnukovo – 2	Moscow	38,600 sq. m
Green Store (phase 2)	Moscow	37,000 sq. m
Regions		
X5 Retail Group DC	Yaroslavl	35,000 sq. m
Monetka DC	Ekaterinburg	34,000 sq. m
ReForma	St. Petersburg	33,000 sq. m
Logopark Sigma	Ufa	24,500 sq. m
A Plus Kazan	Kazan	22,400 sq. m

Key warehouse deals of 2018

Tenant/Buyer	Property	Region	Deal type	Total area
Moscow Region				
Leroy Merlin	Bely rast	Moscow	BTS	140,000 sq. m
Lenta	PNK Valischevo	Moscow	BTS	71,600 sq. m
Detskiy Mir	PNK Bekasovo	Moscow	BTS	62,000 sq. m
Auchan	Yuzhnye Vrata	Moscow	Lease	53,000 sq. m
Vkusvill	PNK Severnoe Sheremetyevo	Moscow	Lease	52,000 sq. m
Regions				
Krasnoe & Beloe	Osinovaya Roscha	St. Petersburg	Lease	38,000 sq. m
Lenta	PNK Tolmachevo	Novosibirsk	BTS	28,000 sq. m

Section 2

HOSPITALITY

- Thanks to the 2018 World Cup frenzy, Moscow registered a 9-percent increase in the number of visitors, reaching 23.5 million in total. At the same time, the World Cup events shifted regular late spring/early summer demand for hotel services to other months, resulting in strong hotel performance in August and September.
- The 2018 net supply growth in Moscow comprised 778 keys. An additional 776 keys opened at the three major airports of Moscow (DME, SVO, VKO).
- With YTD Dec ADR growth of 38.4% and RevPAR increase of 46.1%, the wider market's operating performance in 2018 was truly outstanding. Detailed analysis of the monthly dynamics of the main operating parameters shows, however, that the 'mega-sporting event effect' was rather short-lived and largely evaporated by Nov-Dec.

~60 '000 keys

Overall estimated classified room stock (net of hostels and serviced apts)

City of Moscow's and Cushman & Wakefield's estimates, June 2018

20,100 keys

Modern quality room stock

Cushman & Wakefield's estimates, 12 months 2018

778 keys

In 3 new hotels in Moscow

Net room stock increase over 12 months 2018

776 keys

In 3 new airport hotels

Net room stock increase over 12 months 2018

THE MORE AIRPORT HOTELS, THE MERRIER

Almost equal supply growth in Moscow and its airport submarket.

778 keys

New supply in Moscow over 12 months 2018

3 new hotels

776 keys

New supply at Moscow airports over 12 months 2018

3 new hotels

Source: Cushman & Wakefield

New supply in Moscow in 2018

Hotel project	Keys	Opening
Holiday Inn Express Khovrino (ex-Sozyuz)	171	Q2
Radisson Blu Olympiysky	379	Q4
Pentahotel	228	Q4
Total	**778**	

New supply at Moscow airports in 2018

Hotel project	Keys	Opening
Ibis Moscow Domodedovo Airport	152	Q1
Holiday Inn Express Moscow - Sheremetyevo Airport	192	Q1
DoubleTree by Hilton Moscow – Vnukovo Airport	432	Q2
Total	**776**	

HOTEL SUPPLY GROWTH IS SLOWING DOWN - TEMPORARILY

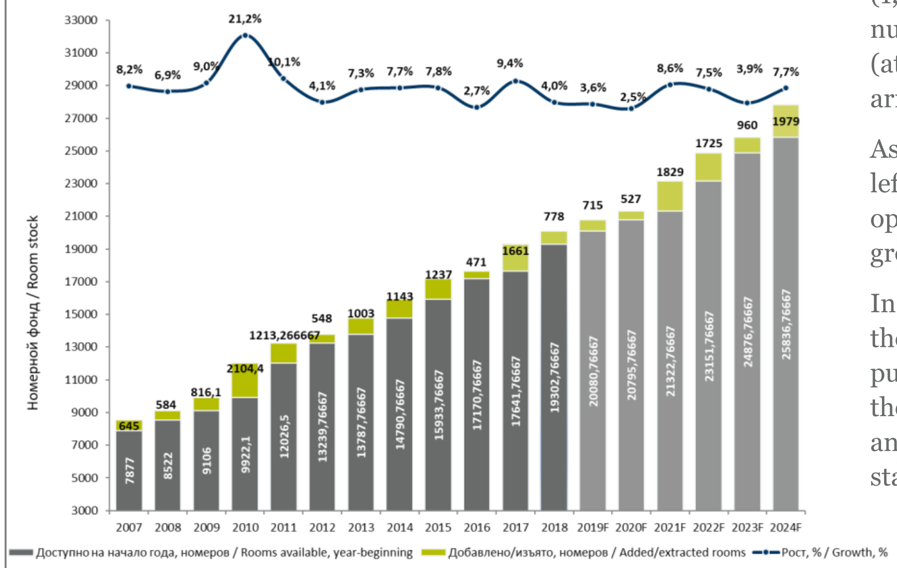
Growth rates are lower than in 2017 – but there is no reason to worry yet.

4.0 %

Year-on-year growth in 2018

Actual market growth vs. 2017

Supply growth dynamics – actual and projected



Source: Cushman & Wakefield

After a 9.4-percent growth of room stock in 2017 (1,661 keys), 2018 saw only a 4% increase in the number of new rooms, with the bulk of those rooms (at the Radisson Blu Olympiyskiy and Pentahotel) arriving only in the last quarter.

As the hotel development pipeline in the graph to the left demonstrates, with only 715 keys expected to open over the next 12 months, the active supply growth is not expected to resume in 2019.

In the absence of big improvements to the health of the national economy, hotel developers continue to push construction launches further and further down the road. As a result, the Moscow market's average annual growth rate between 2019-2024 is likely to stay at 5.6%.

WHICH PROJECTS ARE EARMARKED FOR OPENING IN 2019?

Majority of rooms to open later in the year.

3.6 %

Expected supply growth in Moscow in 2019

4 new hotels

715 keys

New rooms in Moscow in 2019

4 new hotels

Source: Cushman & Wakefield

New supply in Moscow in 2019

Hotel project	Keys	Opening
Holiday Inn Express Baumanskaya	128	Q1
Crowne Plaza Park Huaming	340	Q4
Mercure Neglinnaya	100	Q4
Hampton by Hilton Rogozhsky Val	147	Q4
Total	**715**	

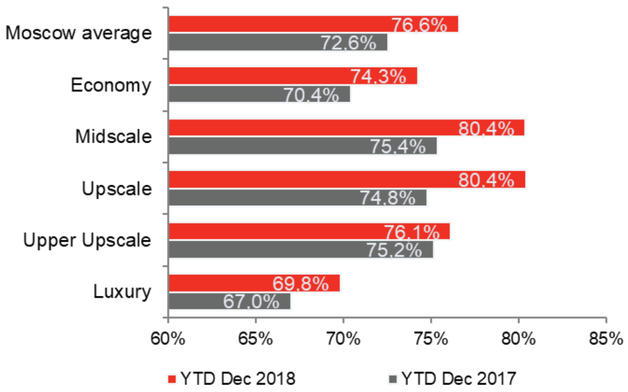
2018... IT WAS A VERY GOOD YEAR©

All Moscow hotels scored big during the 2018 FIFA World Cup.

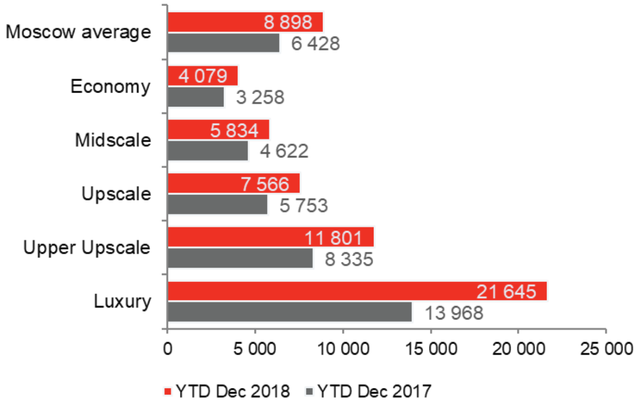
76.6 % Occ, YTD Dec 2018
Wider market

38.4 % Change in ADR (RUB), YTD Dec 2018
Wider market

Occ, YTD Dec 2018, by segment



ADR (RUB), YTD Dec 2018, by segment



The average Occ level for the wider market in 2019 reached 76.6%, which is 4.0 percentage points higher than a year ago. The most popular hotels with the highest levels of occupancy were Upscale and Midscale properties, each recording 80.4%. The minimal growth in occupancy (1 p.p.) was registered only in the Upper-Upscale segment.

The “Championship effect” affected ADR levels across all price segments, with the average growth rate for the wider market reaching 38.4% (from 6,428 RUB in 2017 to 8,898 RUB in 2018), with the highest increase attributable to the Luxury segment (+55.0%, to 21,645 RUB).

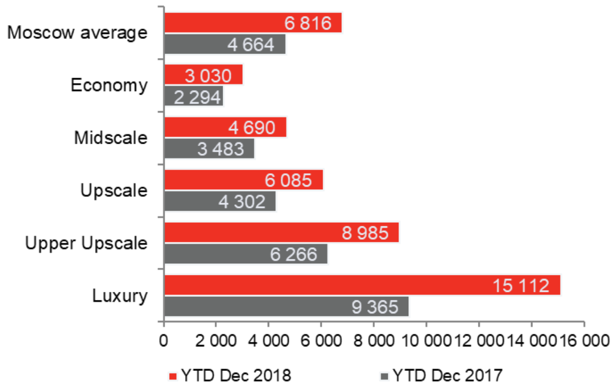
Source: Cushman & Wakefield

EXCELLENT GROWTH OF ROOM YIELD

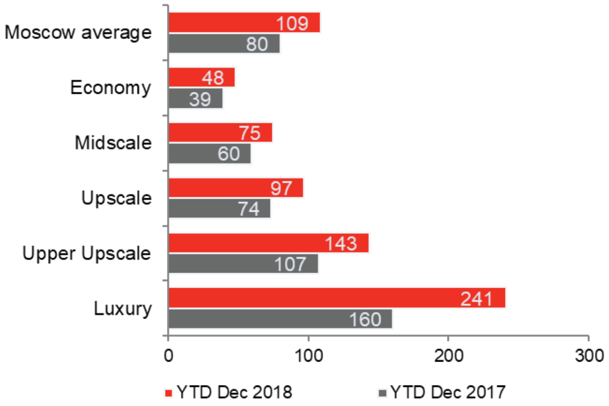
46.1 % Change in RevPAR (RUB), YTD Dec 2018
Wider market

36.0 % Change in RevPAR (USD), YTD Dec 2018
Wider market

RevPAR (RUB), YTD Dec 2018, by segment



RevPAR (USD), YTD Dec 2018, by segment



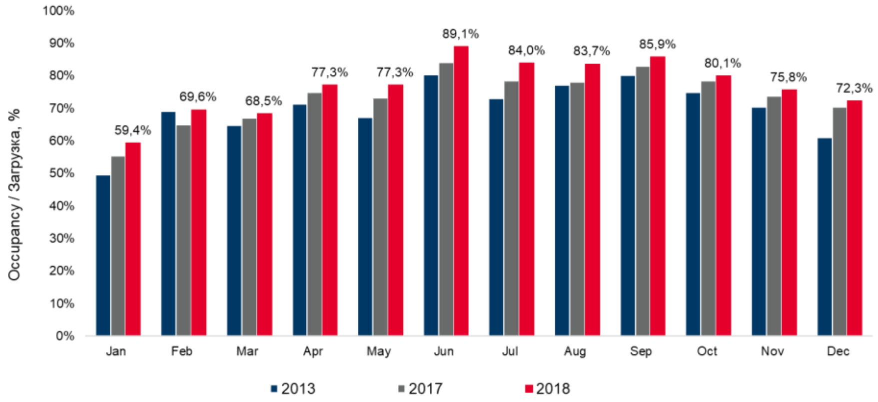
Overall, the Moscow hotels in all price segments were very successful in converting extraordinary demand for accommodation during the 2018 FIFA World Cup event and around it to higher room yields – both in Roubles and USD.

Source: Cushman & Wakefield

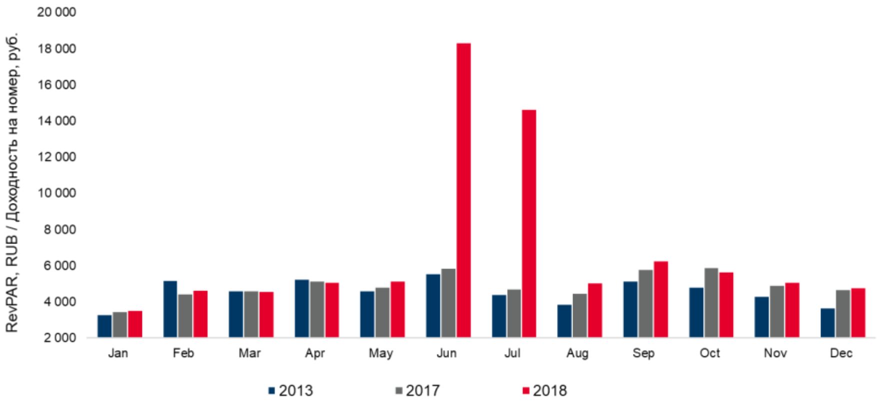
IS THERE LIFE AFTER A MEGA-SPORTING EVENT?

Should the market expect the positive trends to continue after 2018?

Occupancy dynamics, %, by month



RevPAR dynamics (in RUB), by month



Despite the slow start to the year, 2018 became a very successful year for Moscow hotels. Demand explosion, that was expected at the beginning of the summer (perhaps, not in Occupancy but definitely in ADR), displaced more traditional client groups on both sides of the 2018 FIFA World Cup event, softening the 'back-to-business-as-usual' transition period for the city hotels and improving Occ and ADR results in the 'shoulder months'. By the end of 2018, however, the effect of the mega-sporting event largely evaporated, and hotel demand returned to its equilibrium state.

The widely expected surge of leisure demand thanks to football fans exercising their right to re-enter Russia visa-free (re-using fan-IDs) did not materialize. Nor did various visa liberalization initiatives – in theory able to increase visitor numbers in Moscow & St. Petersburg by 10-20% per annum - actively discussed at governmental level immediately after the end of the World Cup.

What does this all hold for 2019? Recent growth in supply (some 2,500 keys added over 2017-2018), so far has not been matched by a substantial improvement of price-inelastic demand which remains suppressed by a whole range of factors including insufficient growth rates of the national economy, sanctions, tax changes, and volatility of the Ruble – this may easily lead to 'price wars' between Moscow hotels: quite a sobering effect for the entire market.

Source: Cushman & Wakefield

#MARKETBEAT

Section 3

APPENDIX

Information and interactive maps

STANDARD COMMERCIAL LEASE TERMS

LEASE TERMS

DURATION OF LEASE

Offices: 3-7 years
Industrial: either short-term (1-3 years) or long-term (5+ years)
Retail: 3-5 years, anchor tenants - 7-10 years.

BREAK OPTION

Offices: Possible after 3 years with penalty. After crisis became very popular. Notice period is 6-12 months. Contract can be terminated from both sides.
Retail: Possible after 2-3 years, subject to negotiation with landlord.

DISPOSAL OF LEASES

ASSIGNMENT AND SUB-LETTING

Offices & Industrial: Usually possible, but subject to negotiation.
Retail: Not common, in some cases subject to negotiation.

MEASUREMENT PRACTICE

Space is measured generally on the BOMA system. Some Landlords apply BTI (Bureau of Technical Inventory) measurements.

RENTAL PAYMENTS

RENT PAYMENT AND FREQUENCY

Offices and retail: RUB or US$ per square meter per year, payable due monthly or quarterly in advance.
Industrial: Rubles.

RENT DEPOSIT

Offices: 3 months rent equivalent (bank guarantee optional, very seldom as landlords prefer the deposit).
Retail: 1-2 months rent equivalent (bank guarantee optional).
Industrial: 1-3 months rent equivalent (bank guarantee optional, very seldom as landlords prefer the deposit)

RENT REVIEWS

After crisis have become more popular, negotiable.

INDEXATION

Offices: at the level of Russian CPI or 4-7% for RUB agreements; 2.5-4% or at the level of USA / EU CPI for agreements in foreign currency.
Retail: 8-10% or CPI in Russia for RUB agreements, 5% or US CPI for agreements in USD.
Industrial: 4-8% (for agreements longer than 5 years not more than 5-6%).

TURNOVER RENTS (only in **Retail**):

Compound rental rates (minimum fixed rent + a percentage of turnover) are almost always used in shopping centers. Normally, the percentage of turnover varies between 12-15% for fashion, 3-7% for anchor tenants.

SERVICE CHARGES, REPAIR AND INSURANCE

REPAIR

Tenant: Internal repairs and maintenance.
Landlord: Structural repairs, common areas.

INSURANCE

Tenant: Contents insurance.
Landlord: Building insurance which is normally charged back to tenant via the service charge.

SERVICE CHARGES

Service charge is payable by the tenant at either an 'open book' basis or as a fixed cost.

UTILITY EXPENSES

Often not included into service charges, but depends on landlord and different types of projects.

Retail: in some cases, service expenses can be increased due to the regular growth of utility expenses after provision of supporting documents.
Industrial: usually paid separately on the basis of actual consumption.

TAXATION

REAL ESTATE TAX

Landlord: the tax depends on the region. In Moscow for office and retail: 1,5% in 2018 of cadastral value. Will increase up to 2% in 2019.

Tenant: can be partly or fully included to service charges paid by tenant.

VAT: 20% (from January,1 2019)

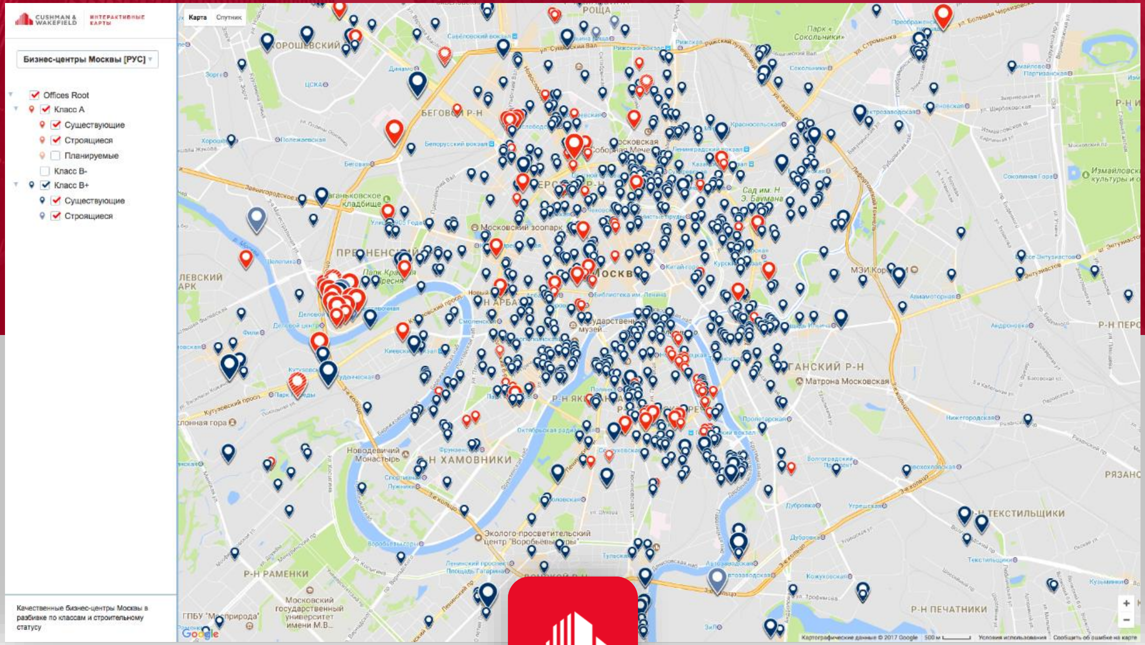
Cushman & Wakefield in Russia

INTERACTIVE MAPS

PROPERTY SEARCH

www.interactivemaps.ru

- Moscow offices
- Shopping centers in Russia
- Warehouses in Russia
- Hotels
- Infrastructure development



COMMERCIAL REAL ESTATE AND INFRASTRUCTURE INTERACTIVE MAPS

CUSHMAN & WAKEFIELD IN RUSSIA

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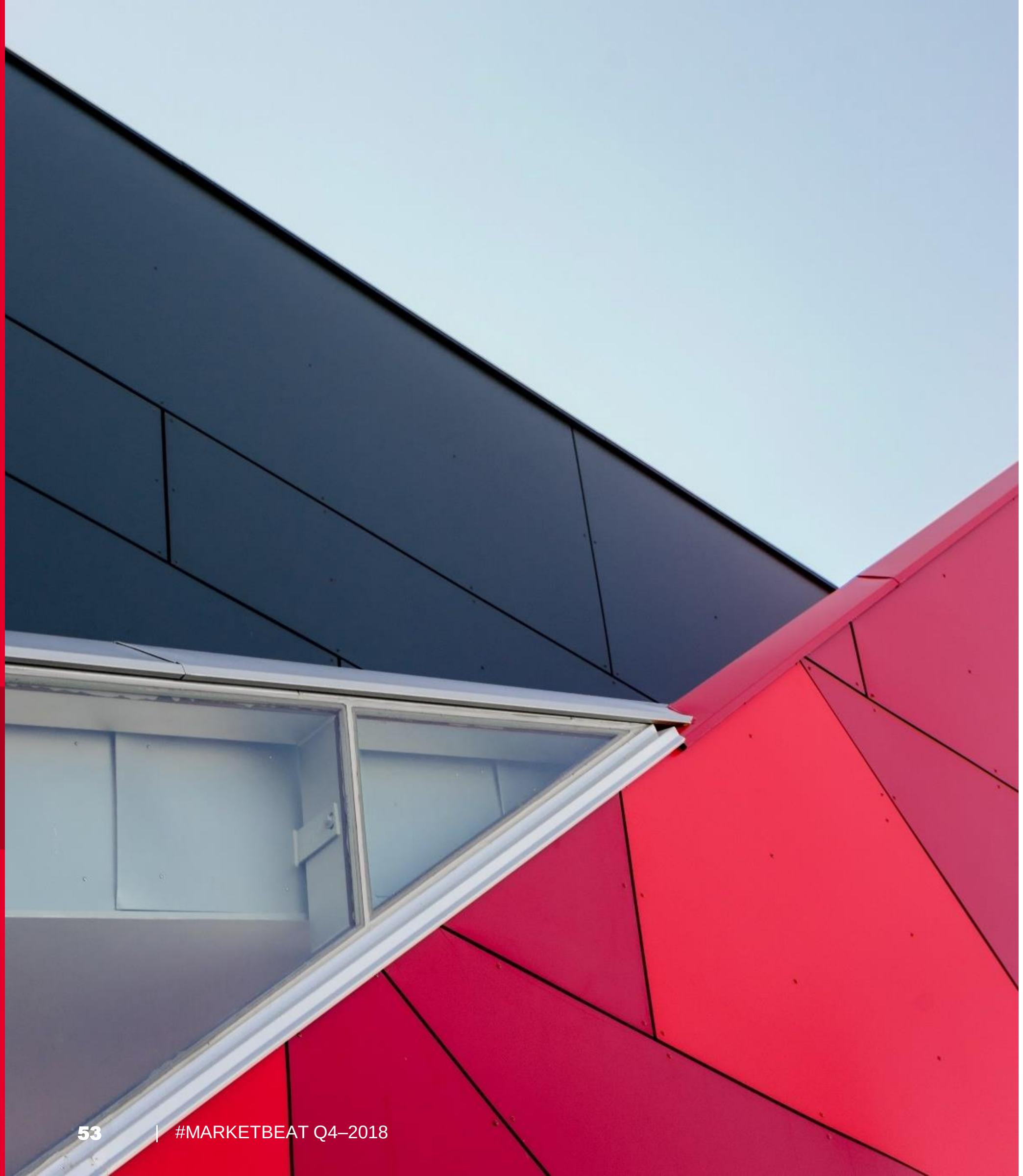

About the company

CUSHMAN & WAKEFIELD IN RUSSIA

Cushman & Wakefield has been successfully operating in Russia since 1995, with employees more than 150 experienced and highly qualified experts. The Moscow office implements projects in all major cities in Russia and the CIS, forming transnational teams for solving complex tasks when necessary. There are 12 key areas of company activity, covering all the sectors of commercial real estate: offices, retail, warehouses, hospitality and tourism, land. The range of services provided includes the leasing of spaces, asset management, investment consulting, real estate operation, services for corporate clients, project management, development consultancy, representing tenant's interests, valuation, hospitality and tourism. Cushman & Wakefield is one of the largest companies in the global commercial real estate market, with a turnover of $6.9 billion and a team of more than 48,000 specialists in more than 400 offices in 70 different countries. For more information, visit our websites – www.cwrussia.ru and www.cushmanwakefield.ru

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