CUSHMAN & WAKEFIELD | #MARKETBEAT

Q1 | 2019

Commercial Real Estate - Russia

#MARKETBEAT

Cushman & Wakefield Research Department

Apr '19

Macroreview

Capital Markets

Office

Retail

Warehouse & Industrial

Hospitality & Tourism

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Outlook

2019-2023 IS A NEW ERA OF EXPENSIVE MONEY

After transitional period of 2014 – 2018 new era had begun. We will see low growth rate, shrinking consumer market and high real lending interest rates. As the result gaps between regions and industries will widen.

BRIEFING: TRANSITION PERIOD IS OVER

5-year transition period is over. In 2014-2018 we have moved from the integration to the sovereign economy, isolated from external factors.

According to the new reality Rosstat recalculates indicators, the Central Bank implements new reporting system, The Ministry of Economic Development published the forecast up to 2036.

In 2014 – 2018 there were fundamental changes in the functioning and structure of the Russian economy.

New era starts from 2019 and will be focusing on the large scale projects driven by the state. Economy is expected to remain rather stable, however the declining quality of Russian market data will make successful business decisions more difficult.

Stable prices, rents, no speculative bubbles, growing disparity between successful and lagging industries, companies, cities and regions will be common.

Inflation of costs will put private business margins under pressure. The state will be focusing on large-scale National projects and will stimulate participants with access to cheaper financing.

From real estate perspective this means that new projects will be driven not by market demand, but by ideological considerations. This will result in the degeneration of efficiency and in the demand for management services that can compensate quality gap between supply and demand.

Football stadiums built for FIFA World Cup 2018 and Gazprom headquarters in St. Petersburg are good examples of such approach.

There will be opportunities for private business to position between target KPIs of National Projects and market needs.

Only those companies who will participate in the National projects will be able to outperform the market, however there will be plenty of opportunities for smaller-scale local business.

Key events in 2019:

- WeWork is entering the market. Influence on the co-working market.
- Residential market moves to project financing – dynamics of sales and mortgage.
- Recalculation of the macroeconomic indicators for the previous periods.

Section 1

MACROREVIEW

- 2019 - 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

	2018	2019	2020	2021	2022
GDP growth, %	1.87	**1.40**	1.73	1.72	1.37
RUB/USD	62.67	**65.65**	63.95	63.06	62.84
CPI, %	2.88	**5.07**	3.95	3.73	4.00
GDP deflator,%	9.92	**9.81**	5.97	4.06	4.06
Interest rate, %	8.87	**10.17**	10.18	9.50	8.60
Current Balance, % of GDP	3.05	**1.53**	0.97	-0.14	-0.1
Private consumption, %	2.19	**1.18**	2.11	2.26	2.20
Government spending	0.22	**0.73**	0.94	0.85	0.70
Capital outflow, bn USD	-6.43	**-158**	-121	-115	-111
Unemployment rate, %	4.80	**4.89**	4.81	4.74	4.65
BRENT crude oil price	71.1	**63.7**	65.6	66.8	68.6

Source: Oxford Economics 04/04/2019

2019 - 2023 STAGNATION YEARS

Slowdown in economy along with high real interest rate will decrease construction rates across various sectors of commercial real estate. All the attention is drawn to residential sector.

1.3 %

GDP Growth for 2019

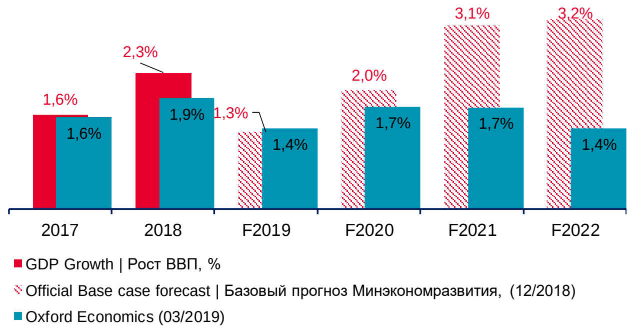
The Ministry of Economics

5 %

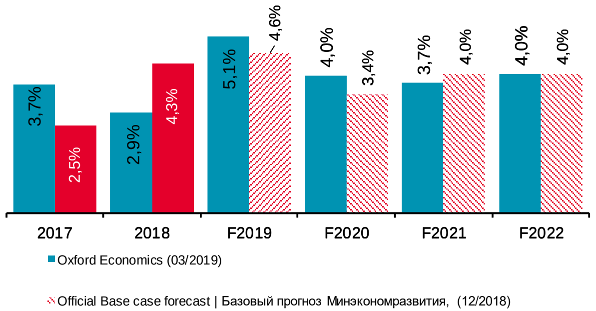
Inflation outlook for 2019

By the Ministry of Economics

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. Official forecast estimates that GDP growth rate will not exceed the world average. However, construction is announced as a major driver for the economy in the coming years. This is a good news for real estate industry.

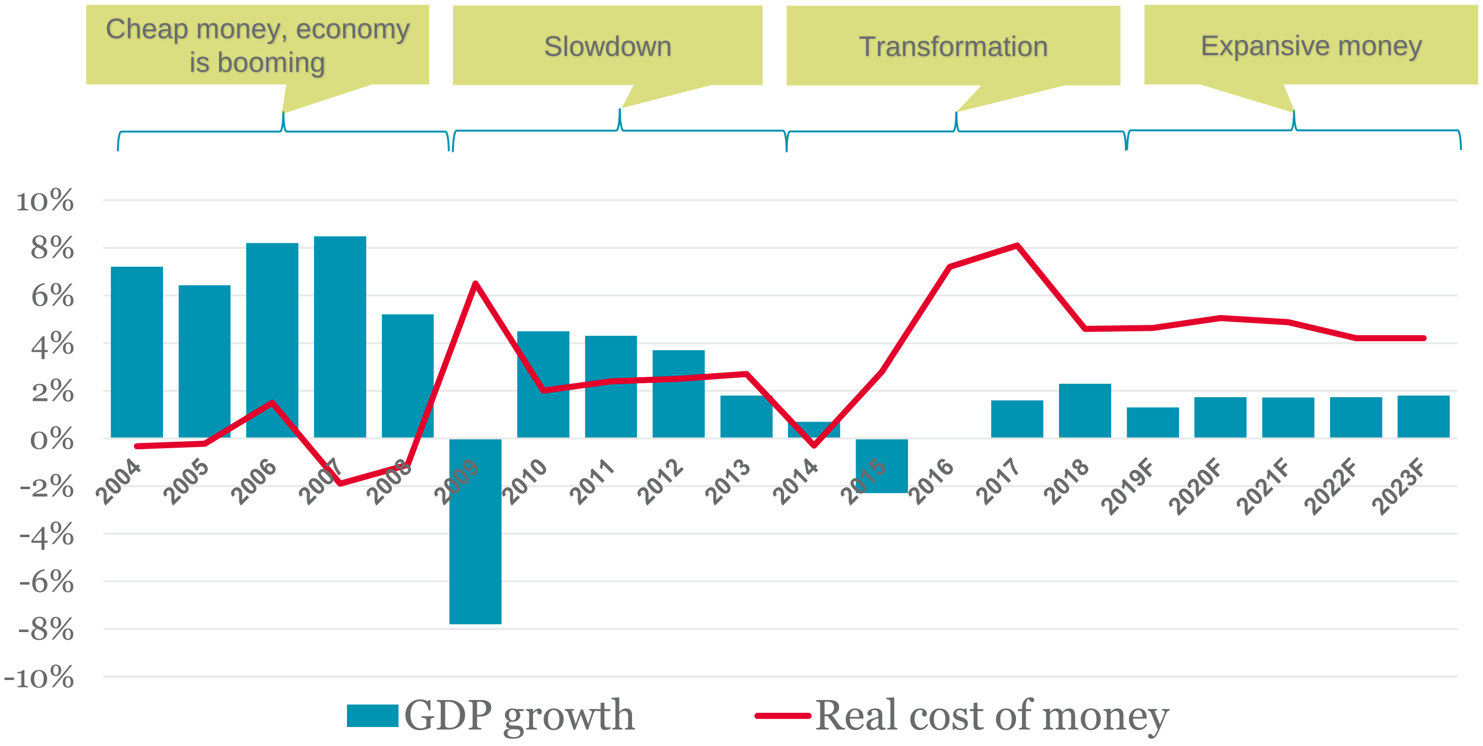
The high rate of non-performing loans in the construction sector raises a question of how realistic this view is.

Review of methodology by the Federal Statistics Office especially affected inflation. Inflation in 2014 was reviewed from 7.8% to astonishing 11.4% retrospectively. Such an increase for previous period allowed to slash inflation in 2017 from 3.7 to 2.5%.

Such manipulation will affect indexation of rental rates that are tied to CPI.

NO CHEAP MONEY AHEAD

Real lending rate and GDP growth



Real lending rate is the market rate adjusted for inflation. Market boom in 2004- 2008 was driven by extremely cheap funding.

From 2019 funding will be the most expansive in 20 years.

Foreign capital will not compete with domestic due to the sanctions and high country risks.

HOUSEHOLD DEBT IS RISING

2019 had started with active growth of household debt, including both mortgage and consumer. However mortgage term increased significantly by 15 months just in in January – February.

12 %

Of mortgage debt was paid ahead of the term

In 2018

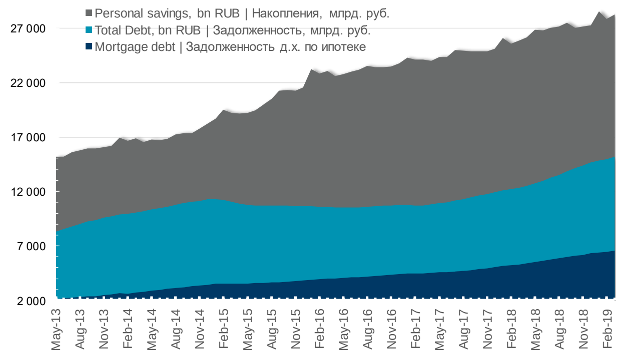
6 %

Share in GDP

Of the mortgage debt in Russia

Source: the Central Bank, Cushman & Wakefield calculations

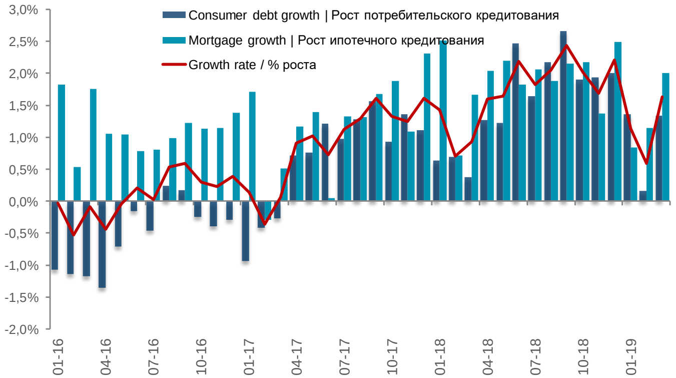
Shares and deposits (of physical persons), bn RUB



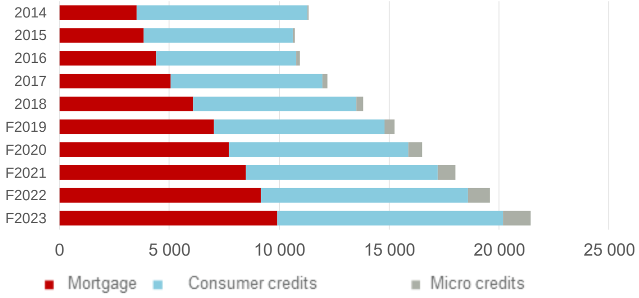
Despite high growth rates, the debt-to-GDP ratio to date remains the lowest in Europe. In Eastern Europe, mortgage loans account for 15-20% of GDP, and in Western Europe they are closer to 70-100%.

The mortgage debt will reach 10% of GDP by 2023 if the growth rate keeps the same high level in the coming years.

Growth rate of household debt



Household debt structure, bn RUB



THE ECONOMICS OF LENDING - A DRY SPELL

2019 started with the shrinking corporate debt. Foreign currency debt is going down and non-performing debt is rising slightly.

7.75 %

Key Rate

Increased by 0,25 in Dec 2018

30 %

Overdue Debt

In Real Estate sector

Power BI

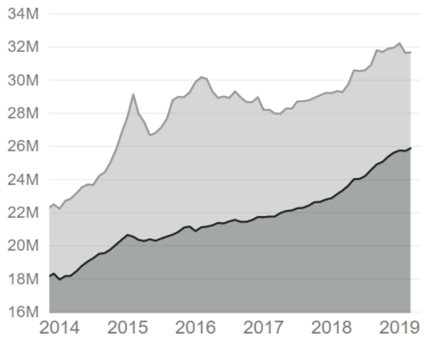
Source: The Central Bank of Russia

The debt of companies, dealing with real estate and construction, has not grown since 2015. The rate of debt in these sectors remains high: 30% for those in real estate and 20% 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.

The end of 2018 saw an accelerated growth of credits in retail. But in 2019 the growth had collapsed. This indicates the period of consumer market stagnation after New Year rush sale. In January – February people prefer to pay back their debts from the previous year.

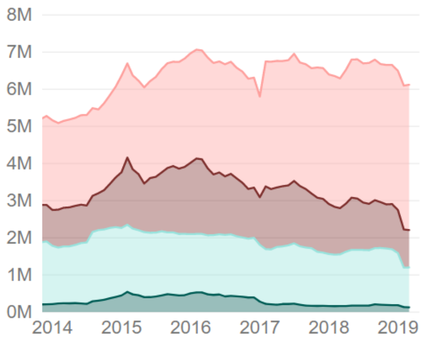
Corporate debt and overdue debt, mn RUB

Total debt



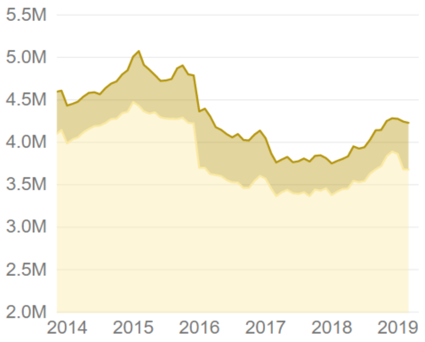
In Rubles (RUB) *In foreign currencies (F.C.)*

Construction and real estate



Construction: *F.C.* *RUB* *Real estate*: *F.C.* *RUB*

Overdue debt



RUB *F.C.*

PUBLIC RETAIL AND DEVELOPMENT COMPANIES

Stock Market Indicators from 03/01/19 to 04/04/2019 as compared to the MICEX index

Stock prices   MICEX index

+8 %

Lenta

The growth leader over the past 90 days

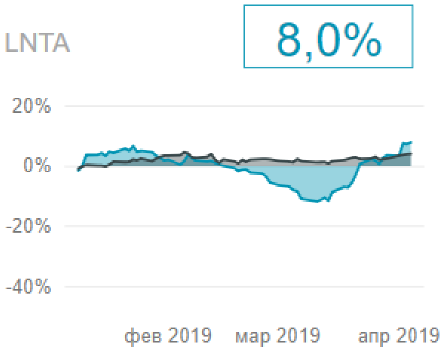
-4.1 %

Magnit

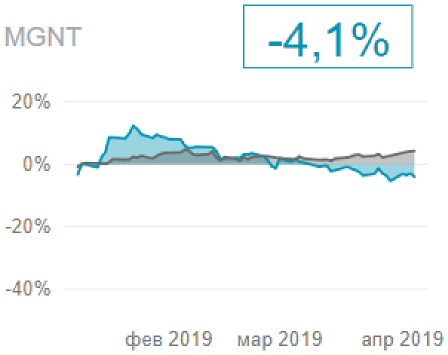
The largest fall for the period of 90 days

Source: MICEX, Yahoo Finance

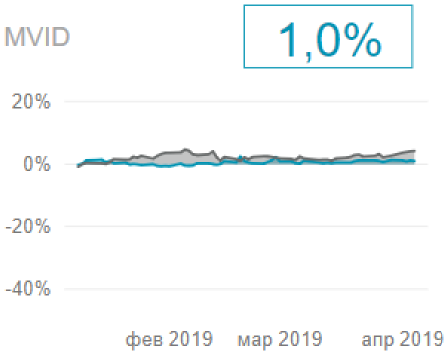
Lenta



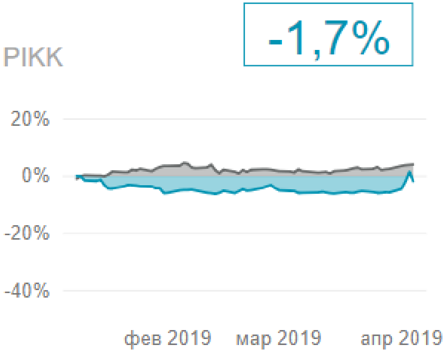
Magnit



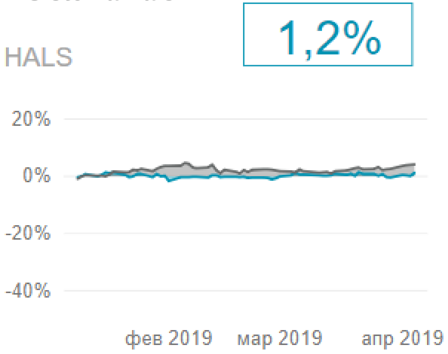
M.video



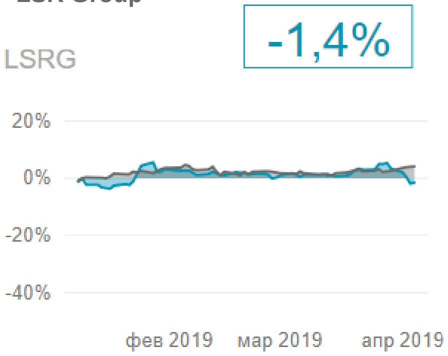
PIK



Sistema Hals



LSR Group



Section 2

CAPITAL MARKETS

- Market had reached its bottom.
- Investment market compression will cause a growth of the capital rates.
- Ice age will continue through 2019.

182 mn EUR
Total investment volume in Russia
In Q1 2019

2.5 bn EUR
Total investment volume in Russia
Forecast for 2019

9.25 %
Capitalization rate, prime office segment
April 2019

-8 %
Investment volume
Compared to Q1 2018

Capital Markets

AFTER SHRINKAGE IN 2018 THE INVESTMENT MARKET WILL TRY TO FIND SOLID GROUND.

Capitalization rates change will follow investment activity revival.

EASTERN EUROPE: SLOW START

In 2019 investments in CEE region were under pressure. In comparison to Q1 2018 market had lost 44% in volumes. However, number of deals in the pipeline suggest that overall volumes in 2019 will be on par with 2018.

-44%

CEE investments in Q1 2019

Compared to Q1 2018

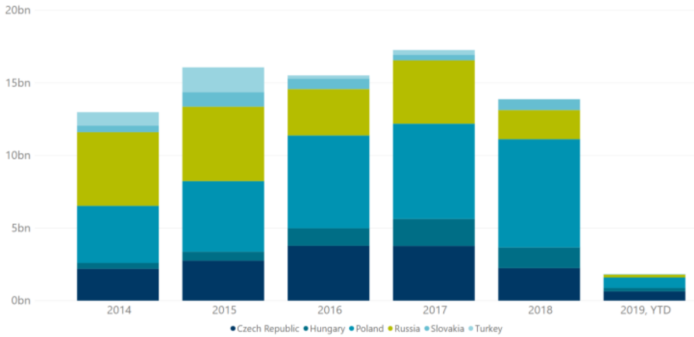
610 mn EUR

Investment volume in Poland, Q1 2019

The largest investment market in CEE region since 2016

Source: Real Capital Analytics

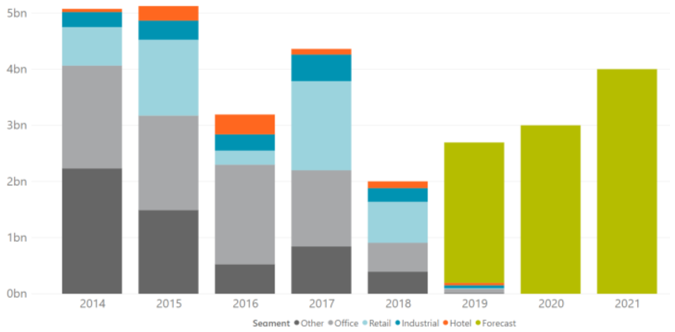
Investments in the core CEE markets, bn EUR



Largest CEE markets attracted 1.6 bn Euro of investments in Q1 2019. It is 44% lower than in Q1 2018.

Poland is still leading in the region with 610 mn Euro, but this market also experienced major decline – 73% compared to Q1 2018 due to a number of large transactions closed in 2018.

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.

In Q1 2019 Russia attracted only 180 mn Euro of investments into real estate – 8% down from previous period.

We expect volumes to catch up in summer, but investment market will remain under pressure.

CAPITALIZATION RATES

9.25 %

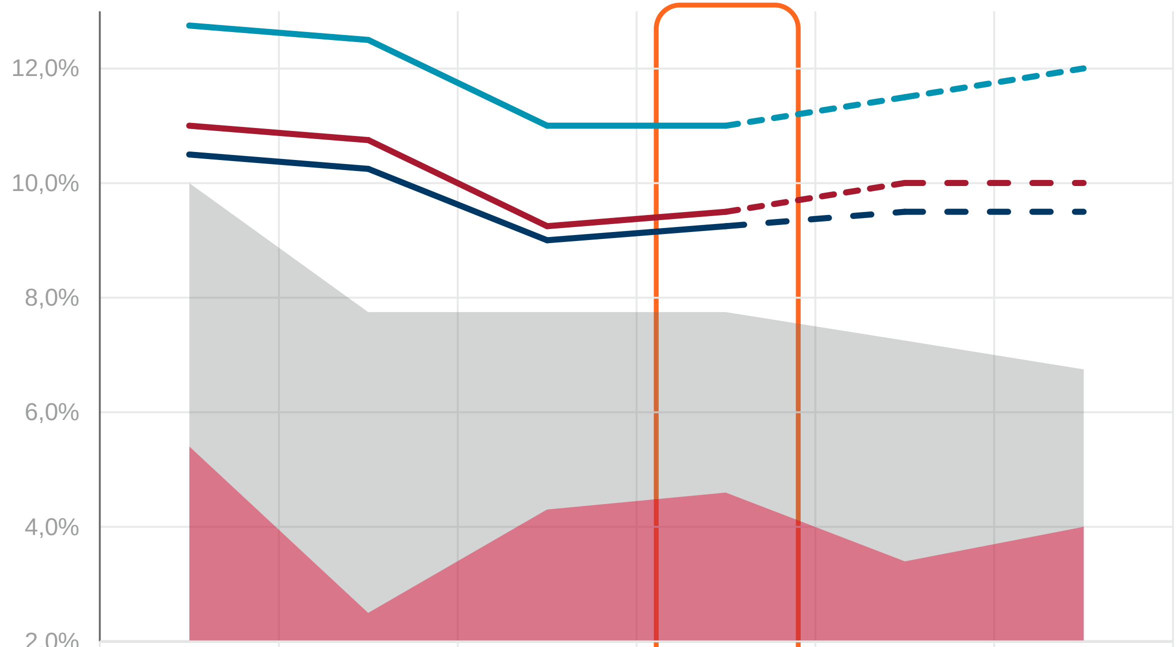
Office

Capitalization rate, Jan 18

7.75 %

The key rate

The Central Bank of Russia



	2016Y	2017Y	2018Y	Q2 2019	2019F	2020F
Central Bank Key Rate	10,00%	7,75%	7,75%	7,75%	7,25%	6,75%
Inflation	5,40%	2,50%	4,30%	4,60%	3,40%	4,00%
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%

Section 2

OFFICES

- After the records of 2018, in Q1 2019 all market indicators stabilized.
- Developers that began construction in the post-crisis 2015-2016 are completing and delivering office buildings into the market against stabilized macroeconomic forecasts and tenant demand for large consolidated blocks.

Moscow Q1 2019

Classes A, B+ & B-

17.49 mn sq. m

Total stock of office buildings

27 ‘000 sq. m

Construction

1,96 mn sq. m (11,2%)

Vacancy

377 ‘000 sq. m

Take-up

Offices

2019 WILL BE DRIVEN BY INDIVIDUAL SOLUTIONS OF MARKET PLAYERS

Tenants have run out of low market opportunities. This year, tenant activity will be determined by individual corporate strategies (termination of lease agreements, expansion/reduction of space, etc.). Perhaps the most successful strategies will be those that are against the market trends.

NEW SUPPLY

After a 15-year minimum for the delivery of new office space, developers return to the activity postponed last year. Thus, new construction this year will offset the effect of the low base of 2018.

27
'000 sq. m
New construction
In Q1 2019

300
'000 sq. m
New construction
In 2019F

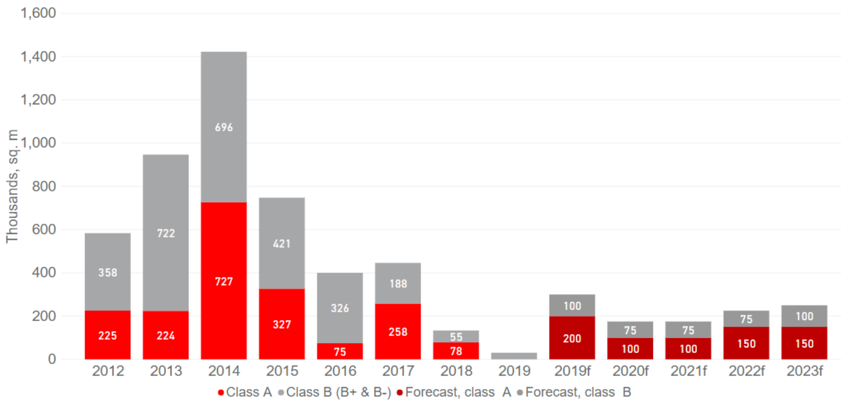
Source: Cushman & Wakefield

In Q1 2019, 3 office buildings were delivered into the market totaling 27,000 sq. m (Brestskaya 2-ya st. 6, BC Krunit, Rassvet bld. 14/16).

In 2019, new construction will increase by almost 2 times compared to the last year and will amount to 250,000 - 300,000 sq. m. This increase is due to such large properties as Iskra Park (58,000 sq. m), Aminevskoye sh., 15 (42,000 sq. m), Stratos (35,000 sq. m), Alcon II (31,000 sq.m) announced to be completed this year.

Construction will be distributed throughout the city, the largest properties listed above will be built outside the TTR.

New construction, class A and B



DEMAND

In Q1, tenant activity was traditionally lower than in other periods. After the records of 2018, we expect demand to stabilize at a level of 1.6-1.8 mn sq. m in the coming years.

377

'000 sq. m

Take-up (lease and sale deals)

In Q1 2019

1.75

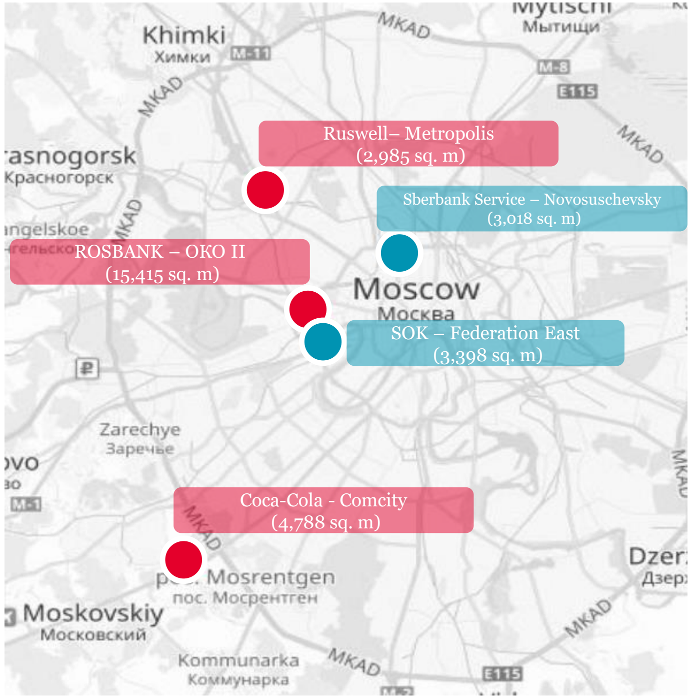
mn sq. m

Take-up (lease and sale deals)

In 2019F

Source: Cushman & Wakefield

Major deals in Q1 2019



Class A Class B (B+&B-)

In Q1, take-up amounted to 377,000 sq. m. In Q1 2018, this figure was higher – 479,000 sq. m, the average for the same period in 2011-2014 – 353,000 sq. m. After record high take-up in 2018, tenant activity returns to a natural level for the market.

The record high take-up last year was a result of tenant rotation on a low market. Therefore, in 2019 we will see a stabilization and a return to balance.

State controlled companies have become the most active players on the office market. In 2014 they accounted for 3% of all deals, while from 2015 to 2018 - 15% of the total take-up on the commercial market. IT companies also covered a noticeable share of demand - 9%. In the coming years, the companies with state participation and IT companies will remain active market players.

DEMAND

The second pre-lease deal for the last 2 quarters as a prerequisite to the improvement of the commercial real estate market.

438 sq. m

Average deal size

Q1 2019

Source: Cushman & Wakefield

In Q1, the second pre-lease deal was closed over the last 2 quarters. This was a deal of Rosbank in BC OKO II (21,702 sq. m - office rentable area), which will be delivered into the market in Q2 2019. Rosbank will occupy the main part of the building (15,415 sq. m). Pre-lease deal shows the improvement on the commercial real estate market and lack of high-quality consolidated blocks in existing buildings.

Despite the fact that there were big deals in Q1, the average deal size significantly decreased first time in the last 5 years and amounted to 438 sq. m (the average deal size over the last 5 years - 650 sq. m). This decrease is a result of an increase in the share of small deals. In 2019, the share of deals of less than 500 sq. m increased and amounted to 45% of the total take-up (by the end of 2018 the share of such deals was 25%). This change in the structure is most likely caused by a lack of high-quality large blocks and tenants searching for alternative options.

ROSBANK

SOCIETE GENERALE GROUP

ABSORPTION

Against the background of the record high take-up in Q4 2018, a lot of vacant premises entered the market and have not been absorbed yet. The absorption went into the negative zone.

By the end of the year, we expect the absorption to be adjusted and return to the positive zone.

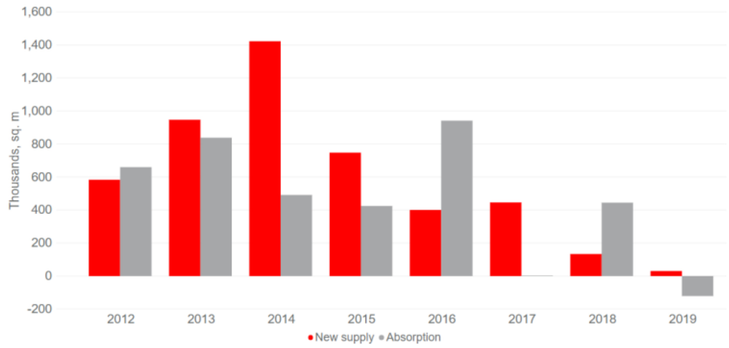
-129

'000 sq. m

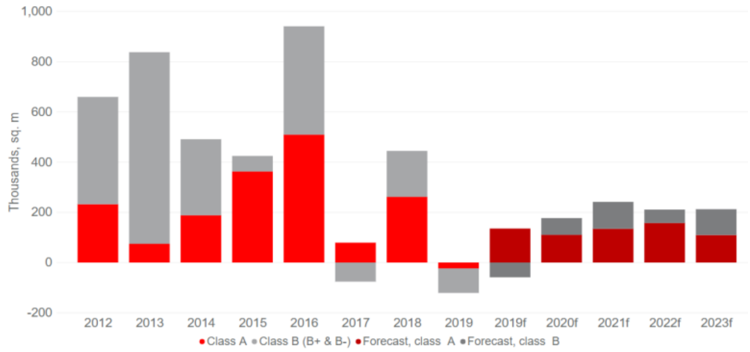
Absorption in Q1 2019

Source: Cushman & Wakefield

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.

VACANT OFFICE PREMISES

In Q1, the vacancy rate increased due to delayed entrance of new vacant premises into the market after the record high take-up in the second half of 2018. Increase of new construction will hold back the decline.

11.2 %

Vacancy rate in Q1 2019

Classes A and B (B+ & B-)

1.96 mn sq. m

Vacant premises in Q1 2019

Classes A and B (B+ & B-)

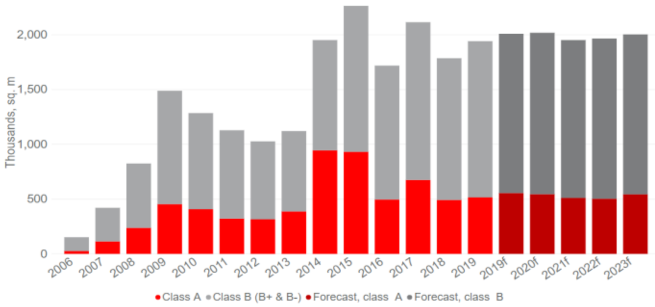
Source: Cushman & Wakefield

Vacancy rates

Against the background of record high demand in Q3-4 2018 and low new construction, the vacancy rate decreased by 1.9 percentage points and amounted to 10,3% by the end of 2018. In Q1 2019, vacancy rate adjusted and returned to the level of the first half of 2018. Currently the market average is 11,2% (Class A – 12,1%, Class B – 10,9%).

The increase in vacancy rate at the beginning of 2019 occurred due to the active relocation of companies in the second half of 2018. Now the released premises entered the market.

Vacant premises



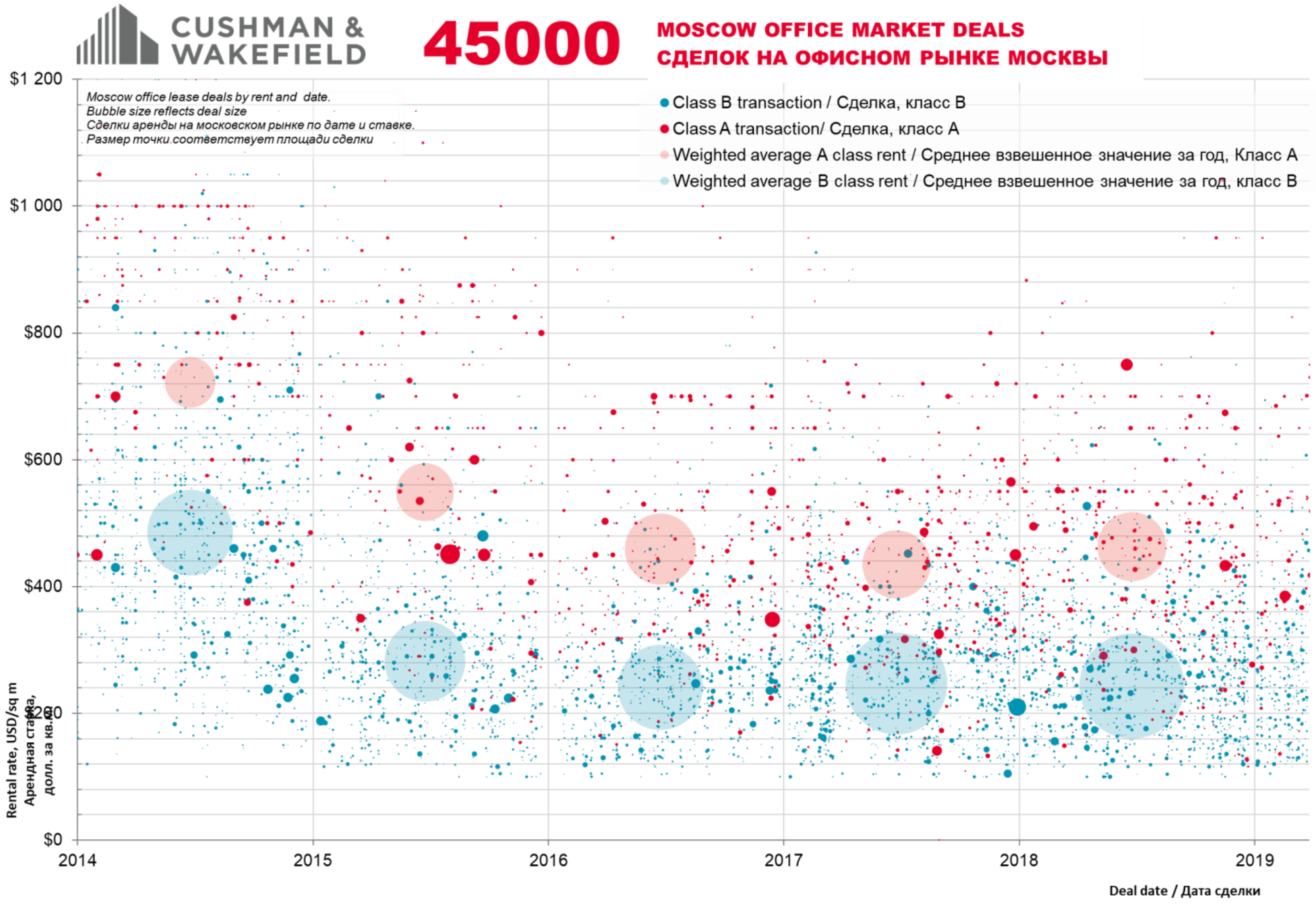
The Center and the West remain most popular when choosing an office. The maximum number of deals was closed in these business areas.

The most significant decrease in vacancy rate occurred in New Moscow and Schabolovsky.

Due to the lack of big vacant blocks in the center, tenants pay more attention to the locations 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

The decrease in average rental rate in Q1 2019 was noticeably affected by a big pre-lease deal. However, we expect that rental rates will flatten out in Q2, and will show an increase of 4-6% by the end of 2019 .

287

USD / sq. m annum

April 2019

Dollar equivalent (all deals in classes A and B)

18,725

RUB / sq. m annum

April 2019

Ruble equivalent (all deals in classes A and B)

Source: Cushman & Wakefield

Leasing demand and rental rates

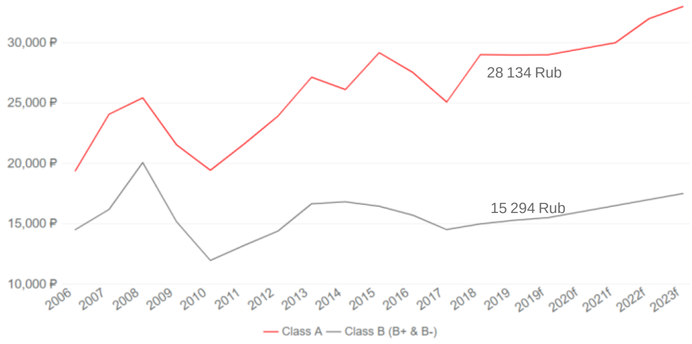
Class	Deal currency	Deals volume, sq. m	Rate
A	USD	12,680	$588
	RUB	57,504	26,805 rubles
B+ & B-	USD	3,674	$522
	RUB	303,820	15,043 rubles

In Q1 2019, the average rental rate decreased by 4.4%. This is mainly due to the decline in class A. Rosbank deal affected significantly the average rental rate: the company leased the main part of BC OKO II (class A) - 15,415 sq. m of office rentable area - at a rate lower than the average for the submarket City.

Against the background of growing disparity (significant gap) in rental rates, even within one class, market indicators become more sensitive to large deals. The decrease in rental rate in Q1 is an illustration of this trend, but we do not expect a long-term downward trend in rental rates in Moscow. In Q2 2019 the market will return to the level of 2018 due to an increase of take-up in more expensive segment. At the end of the year, we will see a slight increase of 4-6%.

Rental rates in US dollars

Rental rates in Russian rubles



FLEXIBLE WORKSPACE

Nowadays, the workplace has become more than simply an office: it's a place to interact, collaborate and meet new people. It has had to adapt to match the increasingly strong emphasis placed on atmosphere, design and well-being by the new generation of workers.

- In 2018, the flexible workspace market increased by 40% - 37,000 sq. m were added to the market. The largest openings of the year: SOK Arena Park, SOK Gardens of Beijing, Tablica, SREDA Federation, CEO Rooms Empire.
- In Q1 2019, 9,000 sq. m of flexible workspace were opened.
- WeWork will become one of the largest operators on the flexible workspace market after opening of 3 locations in Moscow in 2019. At the moment, Regus is the largest operator by occupied area.
- From March 2018 to March 2019, the share of chain operators increased from 40% to 70% (by occupied area). As predicted, chain operators are now dominating on the market.

130
'000 SQ. M
MOSCOW FLEXIBLE WORKSPACE STOCK, Q1 2019

1%
FLEXIBLE WORKSPACE AS A PROPORTION OF MOSCOW OFFICE STOCK

WEWORK
KEY OPENING IN 2019

70%
SHARE OF CHAIN OPERATORS

Detailed study of flexible workspace market is available by link or on the website www.cwrussia.ru in the "Research" – "Office space" section.

Section 2

RETAIL

- Driven by consumer credits, retail sales are growing faster than personal income. The growth in 2019 will be moderate.
- Construction activity is concentrated in cities with population of 1 mn+ people. Lower market capacity and weak consumer market make retail projects in smaller cities more risky for developers.
- In 2019 two large-scale projects will be delivered to the market in Moscow. However, construction activity will slow down next year.
- Vacancy rate in Moscow shopping centers continue decreasing.

5.2 mn sq. m

Total quality stock in Moscow

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

300 '000 sq. m

New construction, Moscow, 2019F

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

7.8 %

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

Consumer credits are driving retail sales. There will be no other positive factors influencing consumption this year. Consumer expectations remain on the low level of the last quarter.

1.8%

Retail sales growth

Jan-Feb 2019 compared to Jan-Feb 2018

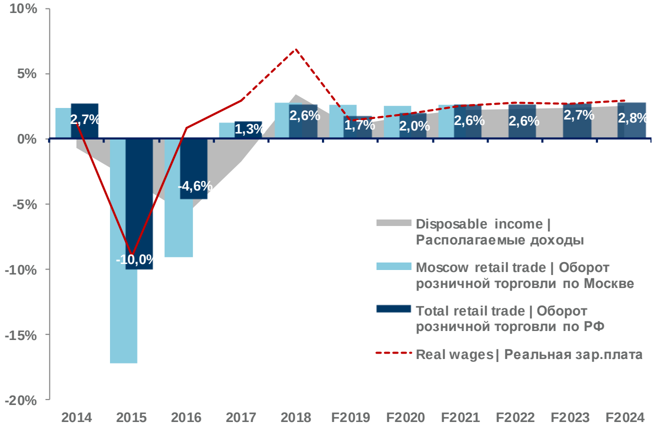
0.9%

Real disposable income growth

1.0% - Forecast for 2019

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

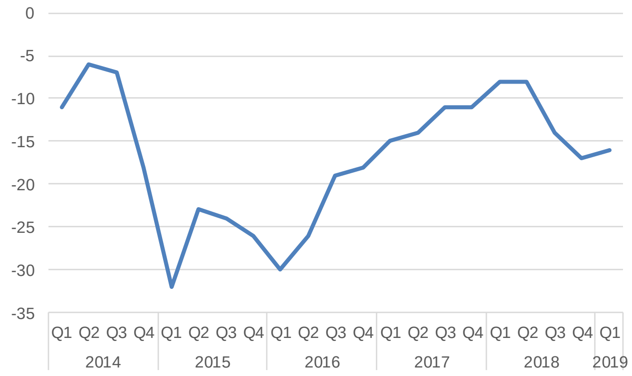
Consumer Market



Retail sales growing faster than personal income. Real wages growth was below 1% while disposable income continue decreasing (-1.3% in Jan 2019 compared to Jan 2018).

The Ministry of Economic Development expects similar numbers by the end of the year. Disposable income growth will be below 1%, retail sales will increase by 1.7%.

Consumer Expectations Index



Consumer expectations remain on the low level from the end of 2018. Despite the fact that consumers predict economic stability for the coming 12 months, they do not consider the current situation as favorable for large-budget purchases.

ECOMMERCE MARKET IN RUSSIA

In 2018, Russian online retail market showed 19% of growth. Cross-border shopping increased by 29%.

1.5 bn RUB

Online sales turnover in Russia *

25%

Share of shopping in foreign online stores

16%

Average annual market growth in 2019-2023

* Estimation includes purchases of physical goods, does not include services, ready-to-eat food, tickets and hotels, gaming purchases, tickets to events. Includes purchases of Russians in foreign online stores.

Source: Data Insight, Cushman & Wakefield calculation

Online sales volume grew by two times for the last five years. The market is expected to grow by 16% on average annually and double again by 2023.

Average purchase size is decreasing both on the local market and in cross border shopping. The market grows due to increasing number of shoppers and purchases.

Top 3 of the largest online retailers in Russia includes Wildberries.ru, Citilink and M.video (Top-10 also includes Ozon, DNS, lamoda, Eldorado, Svyaznoy, technopoint.ru and Petrovich). In 2018 large operators covered the bigger share of the total market growth (Wildberries and Ozon.ru).

Cross border purchases grow faster than the local market. In 2018 number of orders was higher than in Russian online stores. However, the average purchase size in foreign online stores is almost three time smaller than in Russian ones (1160 RUB and 3250RUB, correspondingly).

Specifics of the Russian market:

- The majority of retailers are concentrated in Moscow.
- The largest share of orders are made from large cities.
- Buyers prefer self-pickup to courier delivery.
- A large share of cross border purchases the total online sales turnover.

Retail

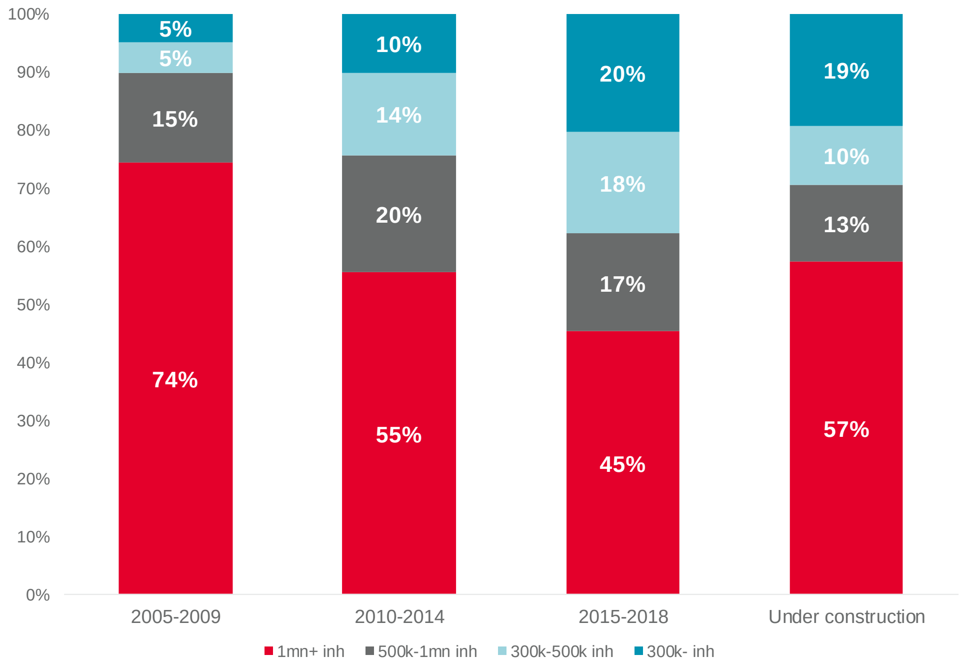
RUSSIA IS BACK TO MOSCOW…FOR A WHILE

Half of retail space planned for opening in 2019 is concentrated in Moscow. Next year the situation will change as there are no more large projects excepted to be delivered to the market. We will see construction activity growth not earlier than in 2021 with opening of retail schemes within large transport hubs.

CONSTRUCTION ACTIVITY IS BACK TO LARGE CITIES

Moscow and other cities with more than 1 mn inhabitants remain more attractive for developers.

Construction activity by city size



At the initial stage of retail real estate market evolution developers were focused on large cities. During the past five years construction activity was more or less evenly spread among the cities of different size.

The retail real estate market is now close to maturity. Against the background of shrinking consumer market and growing competition, developers are moving back to the cities with population of more than 1 mn people. Almost 60% of construction volume is concentrated there. It is too risky for developers to start construction in smaller cities due to low market capacity and purchasing power of population.

Construction activity in the cities with population of less than 300,000 people mostly supported by development of the first large quality retail schemes in the city (for instance, in Grozny, Nizhmnekamsk), new phases of existing properties and construction in the cities of the Moscow region where the purchasing power is higher.

RETAIL REAL ESTATE MARKET IS REACHING MATURITY

In 2019-2021, around 500,000-700,000 sq. m of retail space annually will be delivered to the market.

86

‘000 sq. m

New construction, Q1 2019

Russia (including Moscow)

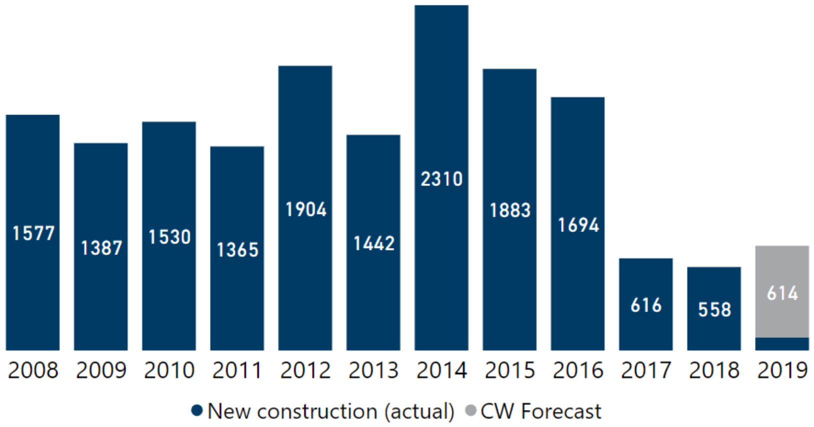
700

‘000 sq. m

New construction, 2019F

Russia (including Moscow)

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



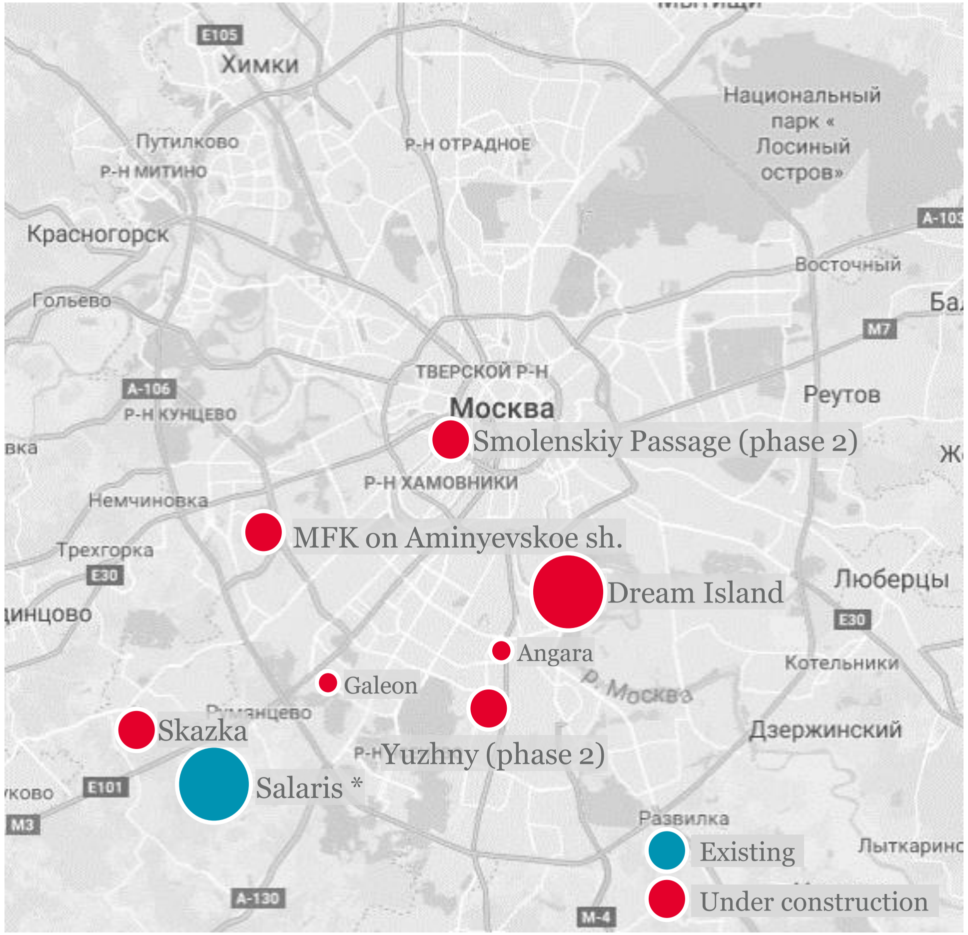
Source: Cushman & Wakefield

In Q1 2019, 3 shopping centers with total GLA of 86,000 sq. m were opened in Russia. Kalina Mall (GLA – 46,000 sq. m) in Vladivostok was the largest opening of Q1, with this launch new international retailers entered the city.

Even though no new shopping centers were opened in Moscow, the largest share of new retail space in 2019 will be constructed in the capital due to the opening of three large-scale projects, such as Salaris (GLA – 105,000 sq. m), Dream Island (GLA – 70,000 sq. m), MFC on Aminievskoye Highway (GLA – 44,000 sq. m).

Ramus Mall (GLA – 70,000 sq. m) in Nizhnekamsk will be the largest shopping center opened in the regions of Russia. The property will become the first quality shopping center in the city.

Shopping centers opened and planned for delivery in 2019 in Moscow



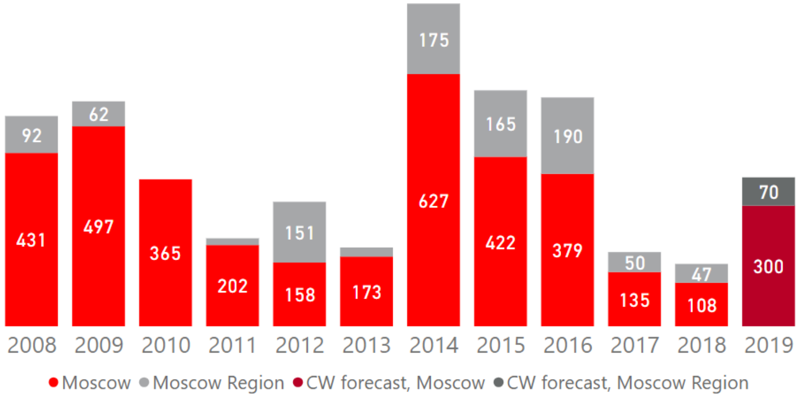
* Soft opening of Salaris shopping center (GLA – 105,000 sq. m) took place in April 2019. This is the first retail scheme opened within transport hub.

Retail

NEW CONSTRUCTION IN MOSCOW

In Q1, no new quality shopping centers were opened in Moscow.

New construction in Moscow, '000 sq. m



The trend on construction of smaller shopping centers is more obvious in Moscow than in other parts of Russia. Even though there are three shopping centers with GLA of more than 40,000 sq. m in the pipeline for 2019, the average size of a shopping center under construction is now only 20,000 sq. m, which is two times lower than the average size of an existing retail scheme. This decrease is caused by development of ADG group community centers and small shopping centers within residential complexes and transport hubs.

Vacancy rate in shopping centers opened in 2015-2018

Vacancy rate by shopping center category	2015	Q1 2019
Newcomers (constructed in 2015-2018)	35%	11%
Properties constructed before 2015	7%	10%
The most successful / highly demanded schemes	3%	3%

Retail

MARKET IS SENSITIVE TO NEW LARGE PROJECTS

Vacancy rate is gradually decreasing - in Q1 2019 the average indicator in Moscow reached 7.8%. The decline is caused by low construction volume and increasing occupancy rate of new retail schemes, which were initially opened with high vacancy. However, by the end of 2019 we expect the average vacancy rate to rise back to 9-9.5% due to the delivery of large-scale shopping centers.

When analyzing shopping centers by category, we see the growing competition between the most successful and second-tier retail schemes, where rotation of tenants is high. It should be mentioned, that there are shopping centers that were opened more than 5 years ago that are included to the category of successful retail schemes. To maintain low vacancy rate developers are constantly working on concept update and tenant mix optimization in order to adjust to the changing preferences of consumers.

F&B SEGMENT IS ACTIVELY DEVELOPING

The growth of catering is several times higher than retail trade turnover growth.

1.5%

Retail turnover growth in Moscow

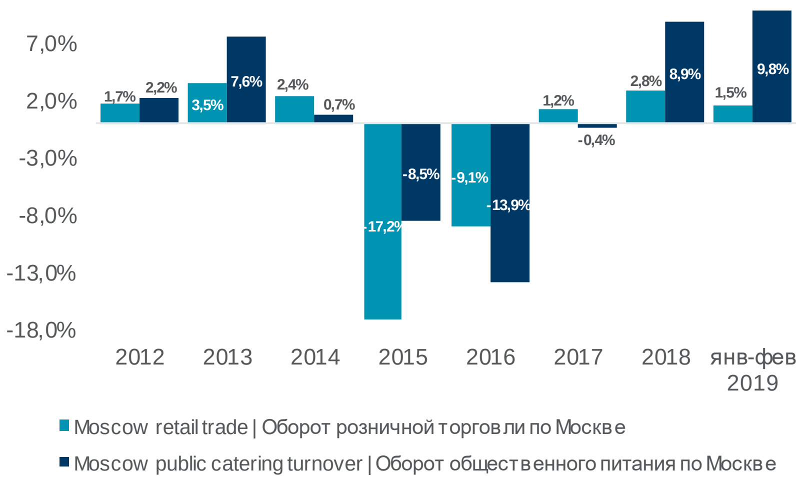
Jan-Feb 2019 compared to the same period of 2018

9.8%

Catering turnover growth in Moscow

Jan-Feb 2019 compared to the same period of 2018

Retail trade and catering turnover in Moscow



Source: Rosstat

In Russia catering turnover growth is also higher than retail turnover growth - 5.2% and 1.8%, correspondingly (Jan-Feb, 2019).

In order to expand target audience operators are experimenting with new formats. To have an opportunity to open at food halls, Teremok launched a fast-casual Pripek brand, KFC opened a restaurant in a new format – Sanders Grill, Starbucks launched a premium coffee shop - Starbucks Reserve Bar.

Opening of Depo food hall at the beginning of 2019 is one of the key events. The total area of the scheme is 11,000 sq. m, including 75 restaurant concepts and 140 farmers' shops.

Food delivery is developing together with F&B segment – Gremm Group is testing its own delivery service from the restaurants presented at Usachevsky market; Yandex.Eda offers to deliver not only ready-to-eat meals, but also products purchased in farmers' corners at Depo.

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

Source: Cushman & Wakefield

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

*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

- Low share of speculative construction and high demand for existing quality properties lead to the decrease of vacancy rate in the Moscow region.
- Lack of quality warehouse space causes potential growth of rental rates in high-demanded warehouse complexes.

MOSCOW, CLASS A

	Q1 2019	2019 (forecast)
Stock (‘000 sq. m)	11,505	12,059
New construction (‘000 sq. m)	96	650
Vacancy rate (%)	7.4	7
Rental rate * (RUB / sq. m / year)	3,700	3,800
Take up (‘000 sq. m)	445	1,300

REGIONS, CLASS A

	Q1 2019	2019 (forecast)
Stock (‘000 sq. m)	8,003	8,357
New construction (‘000 sq. m)	96	450
Take up (‘000 sq. m)	95	450

** Average rent excluding OPEX, utilities and VAT*

Source: Cushman and Wakefield

Warehouse & Industrial. Moscow region

LACK OF LARGE BLOCKS IN POPULAR DESTINATIONS

Developers are looking for new land plots, especially in highly demanded areas (in the South and North of the Moscow region).

HALF OF WAREHOUSE SPACE UNDER CONSTRUCTION IS CONCENTRATED IN THE SOUTH AND NORTH OF MOSCOW REGION

New construction. Moscow region.

96

‘000 sq. m

New construction, class A and B

Q1 2019

700

‘000 sq. m

Take up, class A and B

Q1 2019

Source: Cushman & Wakefield

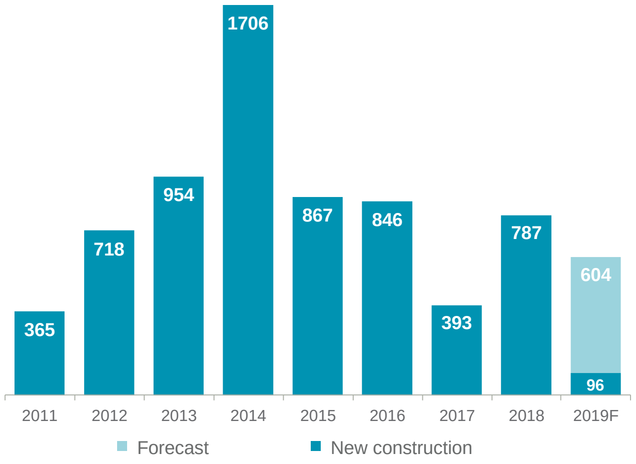
Key warehouse properties delivered in Q1 2019

Property	Highway	Total area
Wildberries DC	Simferopolskoe	48 900 sq. m
VS-Svitino (VS-Logistic)	Kievskoe	27 775 sq. m
VS-Noginsk (VS-Logistic)	Gorkovskoye	13 680 sq. m

Developers prefer built-to-suit projects to speculative construction in the Moscow region – more than 65% of space delivered in Q1 2019 was built-to-suit.

The majority of large projects which are planned to be delivered in 2019 are also built-to-suit: IKEA Esipovo (90,000 sq. m), Lenta in PNK Park-Valischevo (71,000 sq. m), the second phase of Wildberries DC (59,000 sq. m). The share of built-to-suit construction will amount 55% by the end of 2019.

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



VACANCY RATE IS DECREASING

Rental rates and vacancy rates. Moscow region.

7.4%

Vacancy rate, class A

Q1 2019

3,700

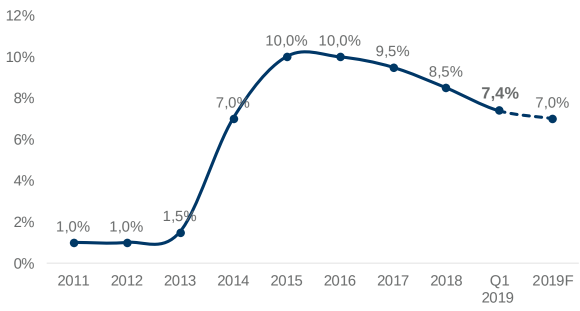
RUB / sq. m / year

Rental rate, class A

Q1 2019

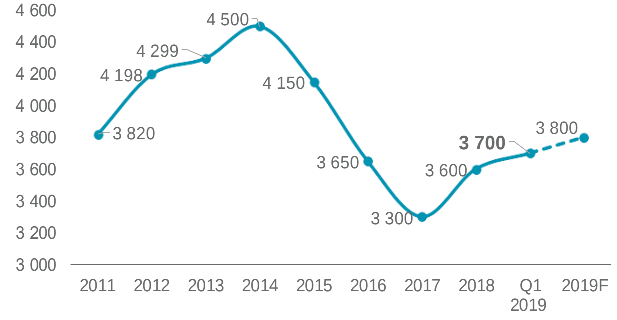
Source: Cushman & Wakefield

Vacancy rate, class A



Low share of speculative construction and lack of quality properties lead to gradual decline of vacancy rate. Against the background of high tenant activity we expect further decrease of vacancy rate.

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



Increase of rental rates is possible in highly demanded properties due to the limited supply of quality warehouse blocks of more than 20,000 sq. m. VAT increase and construction materials' inflation can lead to the increase of rental rates for built-to-suit projects. However, growth of asking rental rates for individual properties is yet not enough for significant changes of average market indicators.

* Average rent excluding OPEX, utilities and VAT

RETAILERS ARE THE MAIN TENANTS

Demand. Moscow region.

479

‘000 sq. m

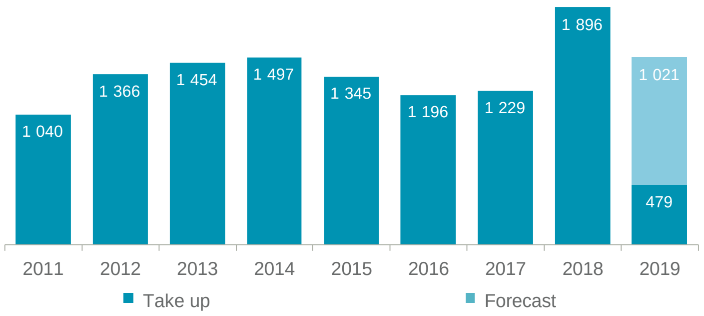
Take up, class A and B
Q1 2019

36%

Share of producers
In the take-up structure in Q1 2019

Source: Cushman & Wakefield

Take up, classes A and B, ‘000 sq. m

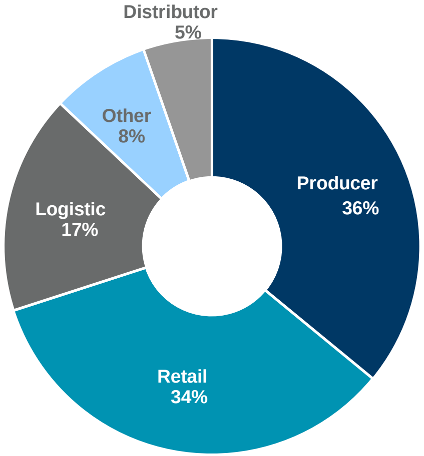


Tenants’ activity remains high. In 2019, we expect the take-up to comprise about 1.5 mn sq. m of warehouse space.

In Q1 2019, average deal size was 14,500 sq. m which corresponds to average deal size in 2018.

Lease deals have the largest share in the take-up structure – 74% of warehouse space.

Take up structure



For the first time in several years, production companies exceeded the market share of retail companies in the take-up structure. However, it is too early to say that this trend is going to remain for the long term. This shift was caused by the largest deal of Q1 2019 – 55,000 sq. m were sold to producing company Mistral in PNK Park Valischevo.

Warehouse & Industrial. Russian regions

LOW LEVEL OF QUALITY SPECULATIVE CONSTRUCTION AGAINST THE HIGH DEMAND

Construction of own warehouses is becoming more popular due to the lack of quality warehouse space.

#MARKETBEAT

CONSTRUCTION ACTIVITY IS GROWING IN SEVERAL REGIONS

Supply and Demand. Regions.

96

‘000 sq. m

New construction, class A and B

Q1 2019

98

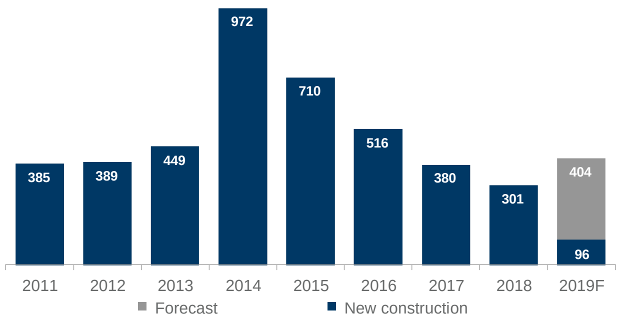
‘000 sq. m

Take up, class A and B

Q1 2019

Source: Cushman & Wakefield

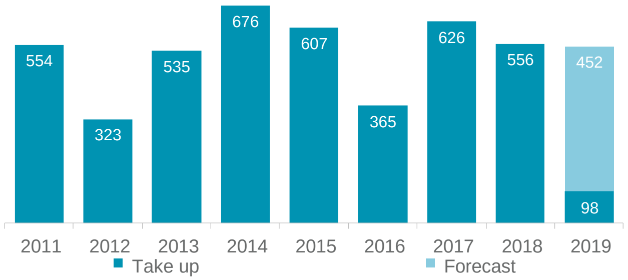
New construction, classes A and B, ‘000 sq. m



In Q1 2019, 96,000 sq. m of warehouse space were delivered to the market which is almost 70% higher than in the same period of 2018. A new building of Sibirsky warehouse in Novosibirsk (40,000 sq. m) and the fourth building of Osinovaya Roscha in St. Petersburg (38,000 sq. m) were the largest properties completed in Q1 2019 in the regions.

In 2019, construction activity will be mostly concentrated in several regions (Ekaterinburg, Rostov-on-Don, Novosibirsk).

Take up, classes A and B, ‘000 sq. m



In Q1 2019, 98,000 sq. m of warehouse space was leased and purchased, which is two times higher than in the same period in 2018. We expect the take up to reach around 550,000 sq. m by the end of 2019.

In the regions, retail companies are the main demand driver. Renewal deal of Eldorado in Q-Park in Kazan (27,300 sq. m) and lease deal of DNS in Terminal Severny in Ekaterinburg (16,900 sq. m) were the largest deals of Q1 2019.

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: 5-10% or CPI in Russia for RUB agreements, 2-5% 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, 1-3% 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.

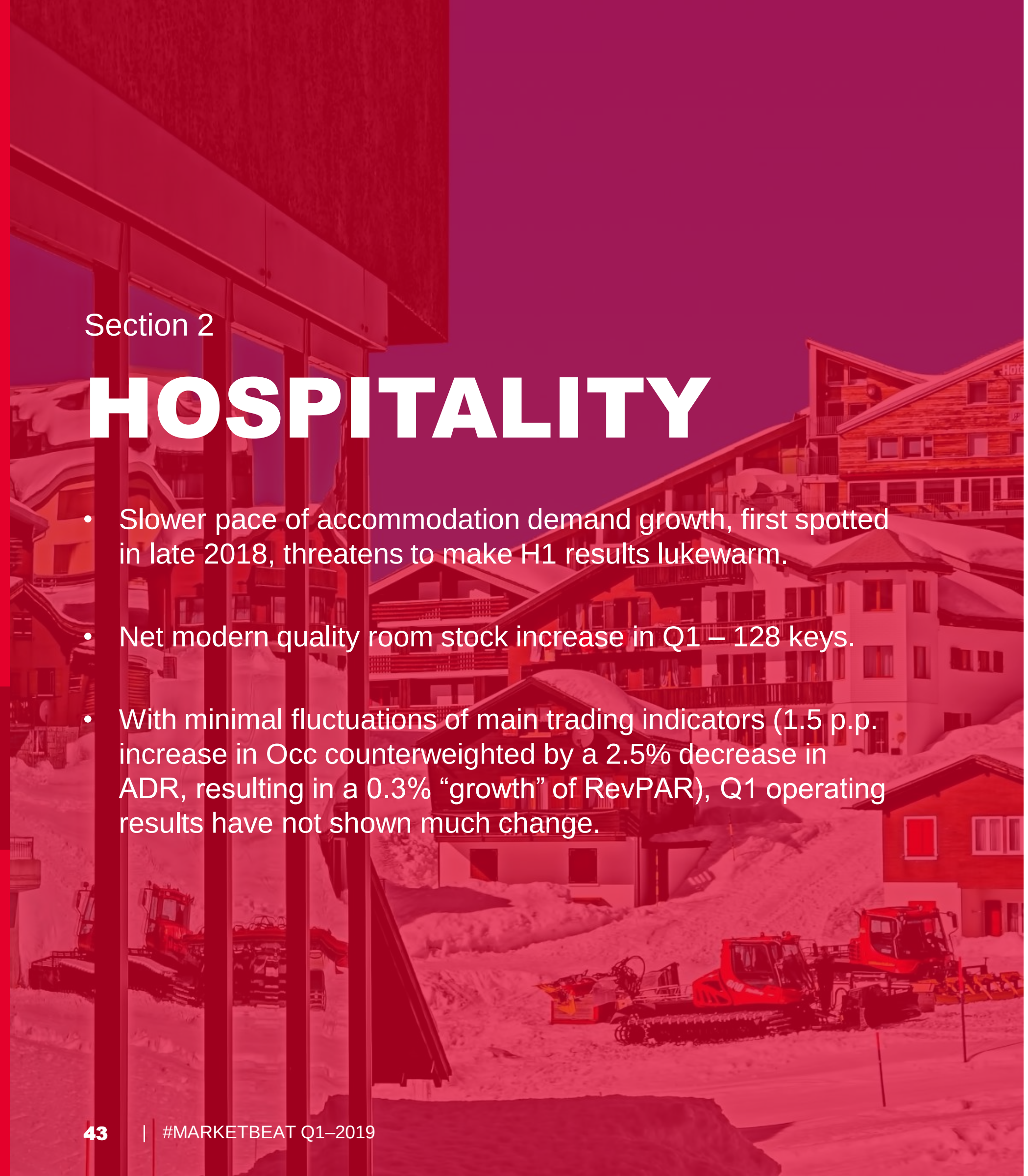
Retail: in some cases, service expenses can be increased due to the regular growth of utility expenses after provision of supporting documents.
Industrial: usually paid separately on the basis of actual consumption.

TAXATION

REAL ESTATE TAX
Landlord: the tax depends on the region. In Moscow amounts to 1.6% in 2019 (1.7% in 2020, 1.8% in 2021).

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

VAT: 20% (from January,1 2019)



Section 2

HOSPITALITY

- Slower pace of accommodation demand growth, first spotted in late 2018, threatens to make H1 results lukewarm.
- Net modern quality room stock increase in Q1 – 128 keys.
- With minimal fluctuations of main trading indicators (1.5 p.p. increase in Occ counterweighted by a 2.5% decrease in ADR, resulting in a 0.3% “growth” of RevPAR), Q1 operating results have not shown much change.

60.4K keys

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

City of Moscow’s and Cushman & Wakefield’s estimates, Q1 2019

20.2K keys

Modern quality room stock

Cushman & Wakefield’s estimates, Q1 2018

128 keys

In 1 new hotel in Moscow

Net room stock increase in Q1 2019

487 keys

In 2 new hotel projects

Net room stock expected in Q2-4 2019

SLOW START OF THE YEAR

Most scheduled hotel openings due in late 2019.

128 keys

New supply in Moscow in Q1 2019

1 new hotel project

New supply in Moscow in 2019

Hotel project	Keys	Opening
Holiday Inn Express Baumanskaya	128	Q1
Crowne Plaza Park Huaming	340	Q4
Hampton by Hilton Rogozhsky Val	147	Q4
Total	**615**	

Source: Cushman & Wakefield

NEXT BIG GROWTH IN SUPPLY – NOT BEFORE 2021

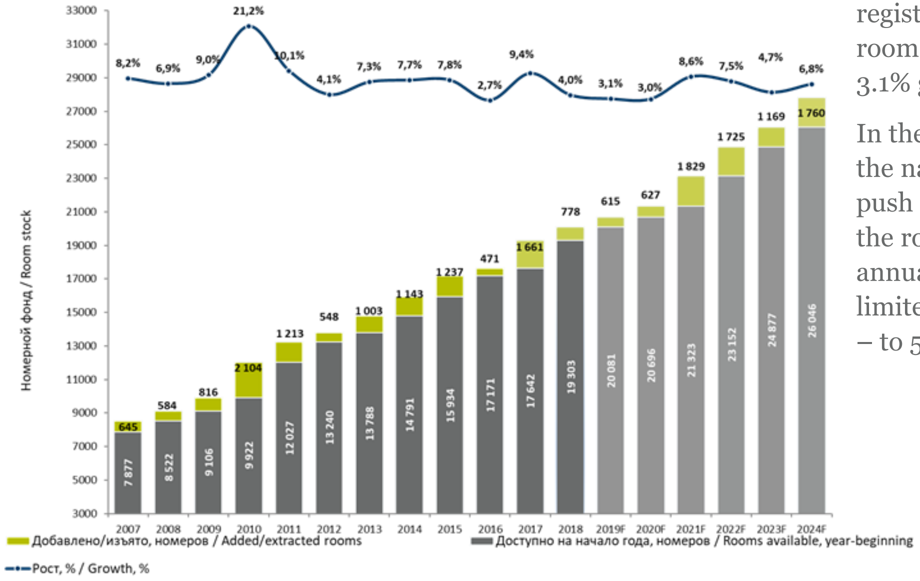
Room stock increase in 2019-2022 likely to remain subdued.

3.1 %

Year-on-year growth in 2019

Expected market growth in 2019

Supply growth dynamics – actual and projected



Source: Cushman & Wakefield

Compared with a 4-percent increase of the market pie registered in 2018, 2019 is likely to see only 615 new rooms to open throughout the year, translating into a 3.1% growth year-on-year.

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 in 2019-2020 is likely to be limited to 3.0% per annum, and between 2019-2024 – to 5.6% per annum.

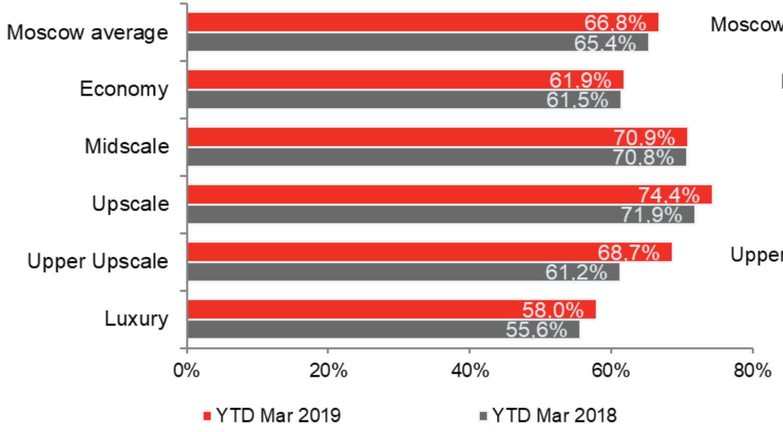
Q1 TRADING RESULTS – UNIMPRESSIVE, SO FAR

Moscow hotels keep trying to estimate real strength of demand.

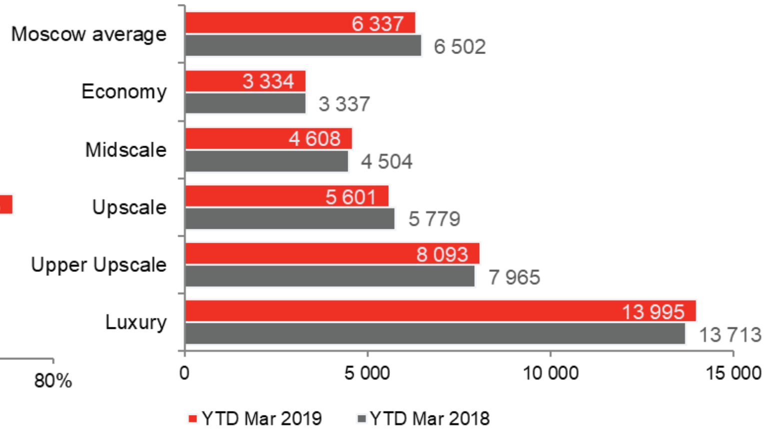
66.8 % Occ, YTD Mar 2019
Wider market

-2.5 % Change in ADR (RUB) YTD Mar 2019
Wider market

Occ, YTD Mar 2019, by segment



ADR (RUB), YTD Mar 2019, by segment



Even though Wider market's Occ grew only 1.5 percentage points vs. the same period in 2018, it was registered in all categories of hotels. Having said that, while Midscale hotels demonstrated a nominal Occ increase of 0.1 pp., Upper-Upscale properties saw their Occ levels jump whopping 7.4 pp.

ADR levels, however, showed a higher variability of results – from small-size growth levels in Midscale, Luxury, and Upper-Upscale segments (2.3%, 2.1%, and 1.6%, respectively) to a subtle negative correction in Upscale and Economy properties (-3.1% and -0.1%, respectively). As a result, the Wider market's ADR indicator saw a 2.5-percent decline year-on-year.

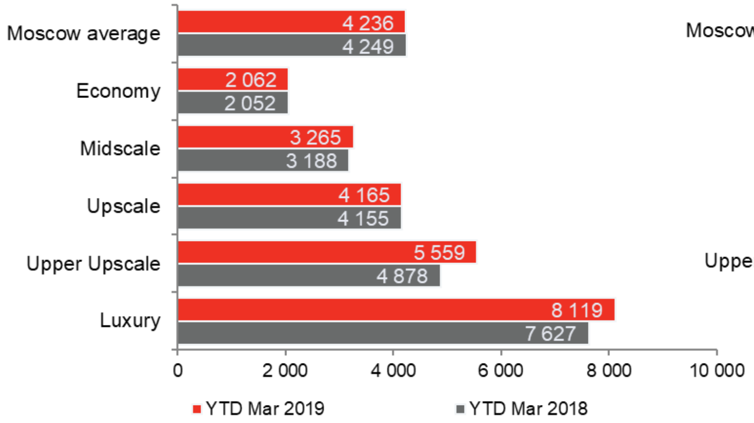
Source: Cushman & Wakefield

ROOM YIELD CHANGE – BARELY NOTICEABLE

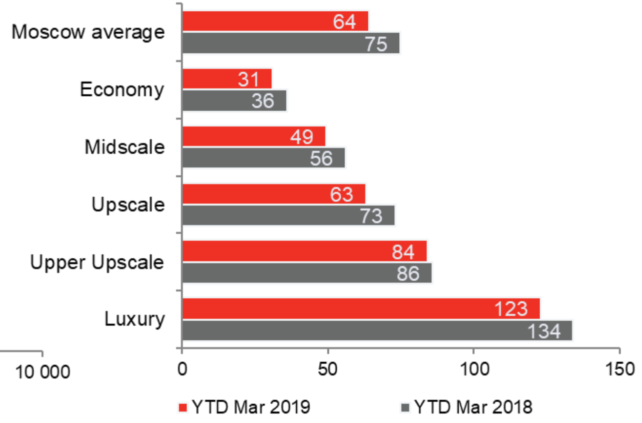
-0.3 % **Change in RevPAR (RUB)** **YTD Mar 2019** Wider market

-14.2 % **Change in RevPAR (USD)** **YTD Mar 2019** Wider market

RevPAR (RUB), YTD Mar 2019, by segment



RevPAR (USD), YTD Mar 2019, by segment



While Wider market's RUB-denominated RevPAR change over the first 3 months of 2019 stayed within the margin of error (-0.3%), Upper-Upscale and Luxury hotels showed more impressive results (13.9% and 6.4%, respectively).

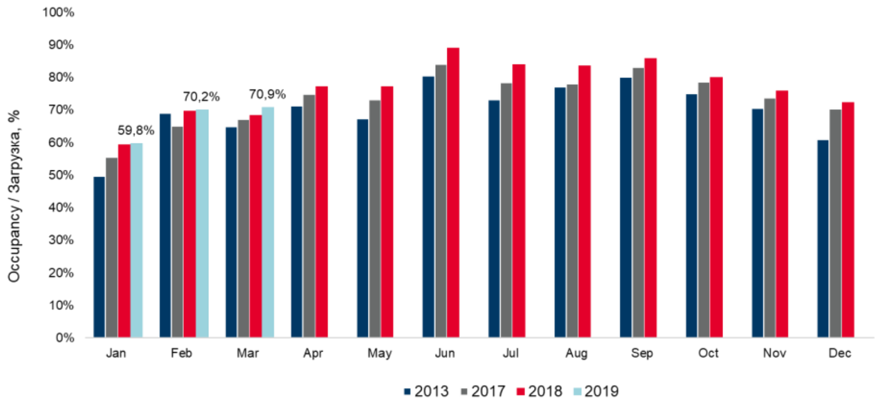
Calculated in US dollars, however, RevPAR dynamics has a more negative feel to it. This is explained by the unstable exchange rate of the national currency, which in 2018 lost 20% of its value before regaining some 8.5% of it back throughout Q1 2019.

Source: Cushman & Wakefield

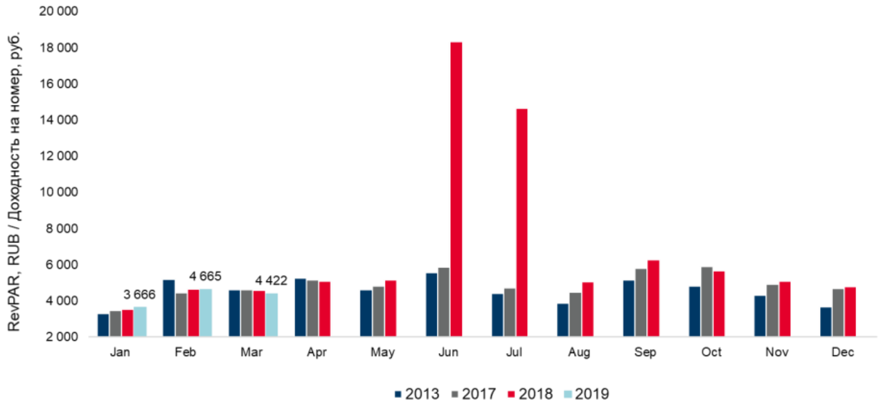
RETURNING TO LIFE AFTER WORLD CUP

What can Moscow hotels reasonably expect in 2019?

Occupancy dynamics, %, by month



RevPAR dynamics (in RUB), by month



Slow start of the year, typical for the Moscow market, and expected loss of business-related demand (the most profitable segment of hotel room sales) over the upcoming May holidays, make local hoteliers concerned over the financial success of the first half of the year.

No evidence of visible improvements to the health of the national economy, coupled with the logical slowdown of business following a “mega-sporting event” year, make the market skeptical about a quick rebound of demand already in 2019.

Market players agree that hotel demand remains sensitive to room rates, so they have been focusing on organic growth of Occupancy levels, in the meantime, patiently pushing for incremental ADR increases.

Source: Cushman & Wakefield

#MARKETBEAT

Section 3

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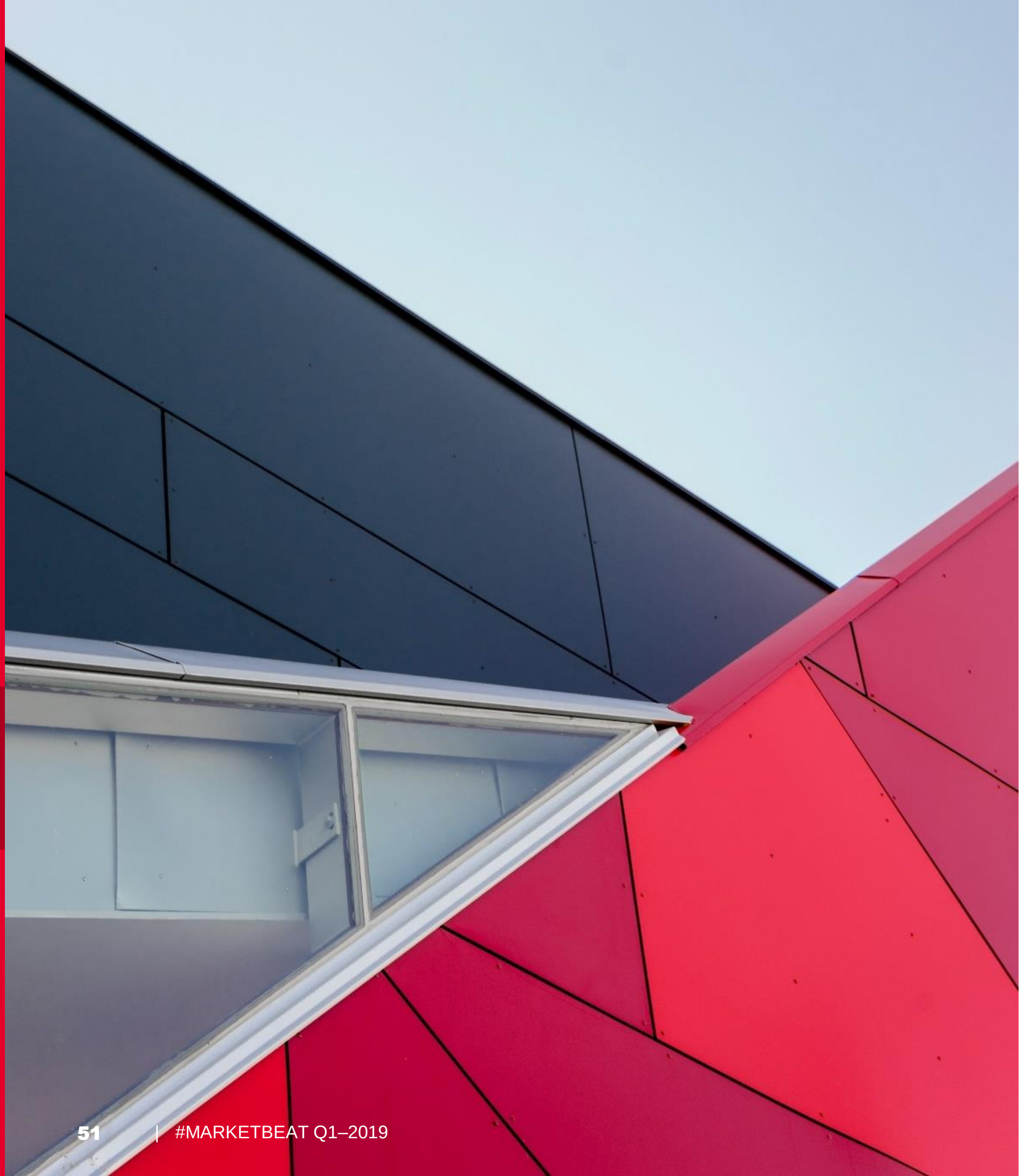

About the company

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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