

FORECAST

OFFICES

May 23rd, 2022

MAY FORECAST

“ The Ministry of Economic Development and the Central Bank issued official forecasts in May. Both regulators do not expect Russian economy to recover in 2023. The whole system goes through a deep structural transformation. So, it is now hard to predict the following scenario including import and export balance and GDP structure even in the mid-term which makes forecasts for 2024 rather provisional. But we can expect growth of the state control and decrease of the consumer sector's share in the economy.

This year inflation may hit 20%, next year there will be 10%, and return to pre-crisis level is expected only by 2025, which means prices will grow by 40% in three years. The real estate sector will not be able to cover such a gap and guarantee the same price dynamics. As a result, we will see a noticeable decrease of prices in real terms.

The ruble is stronger than anybody could expect. Today only importers process US dollars and it shows that import is weak.

Isolated economies always face multiple exchange rates, and it is a close future for us. However, strengthening ruble now provides a window of possibilities for importers. Both strengthening and weakening ruble brings threats and opportunities. The current assumption is that the internal ruble's exchange rate will be high until the financial system is stable.

Exodus of international companies is an important factor influencing the real estate segment. Leaving the country, the companies will have to cover all lease obligations or forward them to new owners. It means that the market is stable at the moment because the transferring process is not cascaded to the level of lease agreements negotiations yet. We expect a major market move to start in June.

Financial modeling now should be based on 40% of inflation for the coming 3 years.

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MOSCOW OFFICE MARKET: YEAR-TO-DATE INDICATORS

	January - May 2022 (YTD)	Indicator's change compared to the same period last year
New Construction, '000 sq. m	44	▼
Take-up, '000 sq. m	624	▼
Vacancy Rate	8.8%	▲
Average Rental Rate*, RUB / sq. m / annum	19,615	▼
Net Absorption, '000 sq. m	-116	▼

**Average Weighted Rental Rates excl. VAT and Operating Expenses*

Office market reacts to economic and political pressure - all market indicators are in the red zone.

Average rental rate decreased by 5% YoY, vacancy rate increased by 0.7 p.p.

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The key change compared to the previous version from 25.03.2022: growth of the vacancy rate will be more significant, and we now expect postponement of some new completions will switch to mass construction freezes.

According to the conservative scenario of the Central Bank, GDP is expected to fall by 10% in 2022 and by 3% in 2023. Thus, economic recovery will begin not earlier than the end of 2023-beginning of 2024.

Increased prices for construction materials and demand shrinkage will lead to low construction activity. In 2022-23 we expect the delivery of properties that were at the final stage of construction. New construction will be at the level of 150,000 sq. m in 2022 (-40% compared to the previous forecast from 25.03.2022).

Average rental rates will decrease by 10% (additionally -5p.p. compared to the previous version from 25.03.2022). There will be few relocation cases, potential tenants will be interested in cost-effective options.

There is a high probability of "stratification" within class A - rates in "prime" objects with low vacancy will remain more or less stable. At the same time, the number of new deals in such properties will be low. The rest of class A (for example, quality buildings in decentralized locations) will compete with class B in the struggle for tenants, and the gap between rates in the two classes will be reducing.

The exodus of international companies will inevitably affect vacancy rate. Despite the localization of businesses, occupied areas will be reduced. Vacancy rate increase will begin in 2022 and continue in 2023. In 2022, the indicator will be at the level of 13% (+1.2 p.p. compared to the forecast of March 25, 2022), and in 2023 - 15.4%.

Release of office premises by shrinking businesses and weak demand will keep absorption in negative zone until 2024.

	2021	2022 January-May	2022*	2023*
New Construction, '000 sq. m	605	44	150	120
Take-up, '000 sq. m	1 940	624	1 000	800
Vacancy Rate	8.1%	8.8%	13%	15.4%
Average Rental Rate**, RUB / sq. m / annum	21,672	19,615	19,600	19,125
Net Absorption, '000 sq. m	902	-116	-803	-343

** Forecast for the year end*

*** Average Weighted Rental Rates excl. VAT and Operating Expenses*

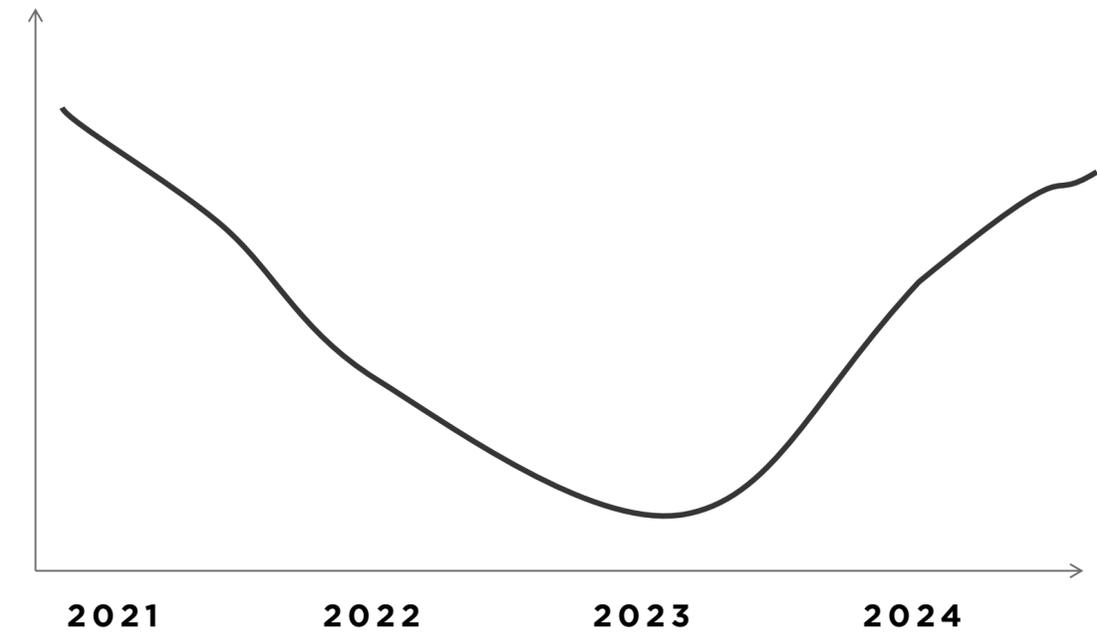
BASE AND CONSERVATIVE SCENARIOS

The Central Bank forecast from May 2022, that implies economy revival from the end of 2023, formed a baseline scenario for office market development. It suggests a U-shaped market recovery. Starting from 2024, a gradual increase in demand will lead to a vacancy rate decrease and rental rates growth. Against the background of low construction activity, all the above will move absorption to the green zone.

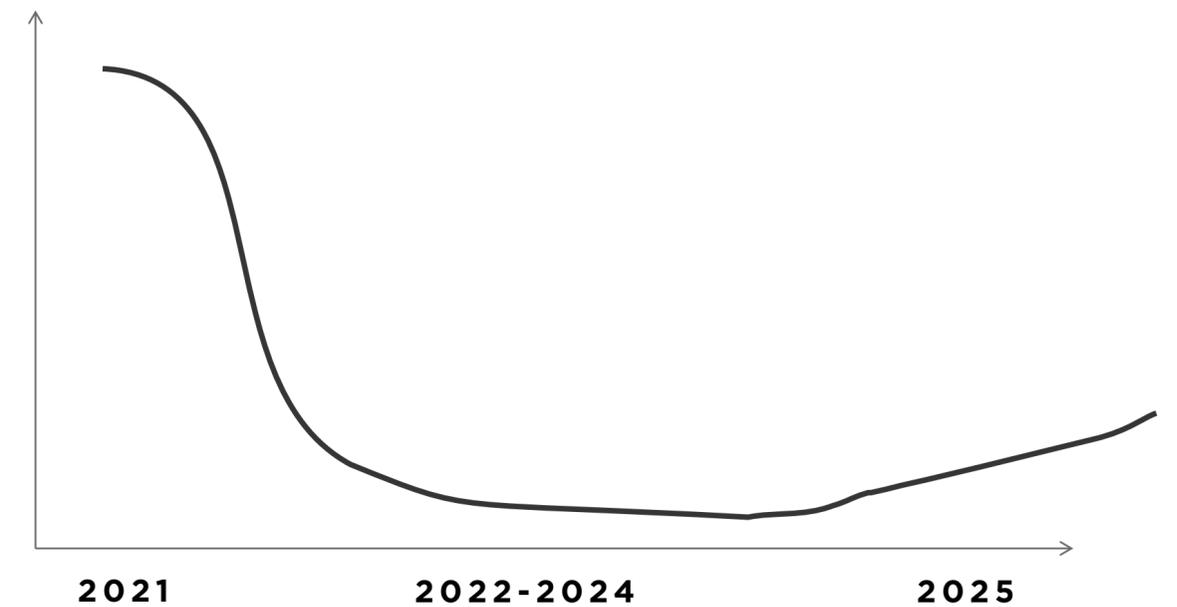
In case of protracted economic recession (L-shaped market recovery) in 2024, new construction and take-up will be low due to the lack of business development drivers, net absorption will still be negative, and rental rates will continue to decline.

Real estate market is very sensitive to expectations, so a prolonged recession will negatively affect the quality of service, construction and design, as there is no point in additional investments that the market is not ready to pay for.

U-Shape Recovery



L-Shape Recovery



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