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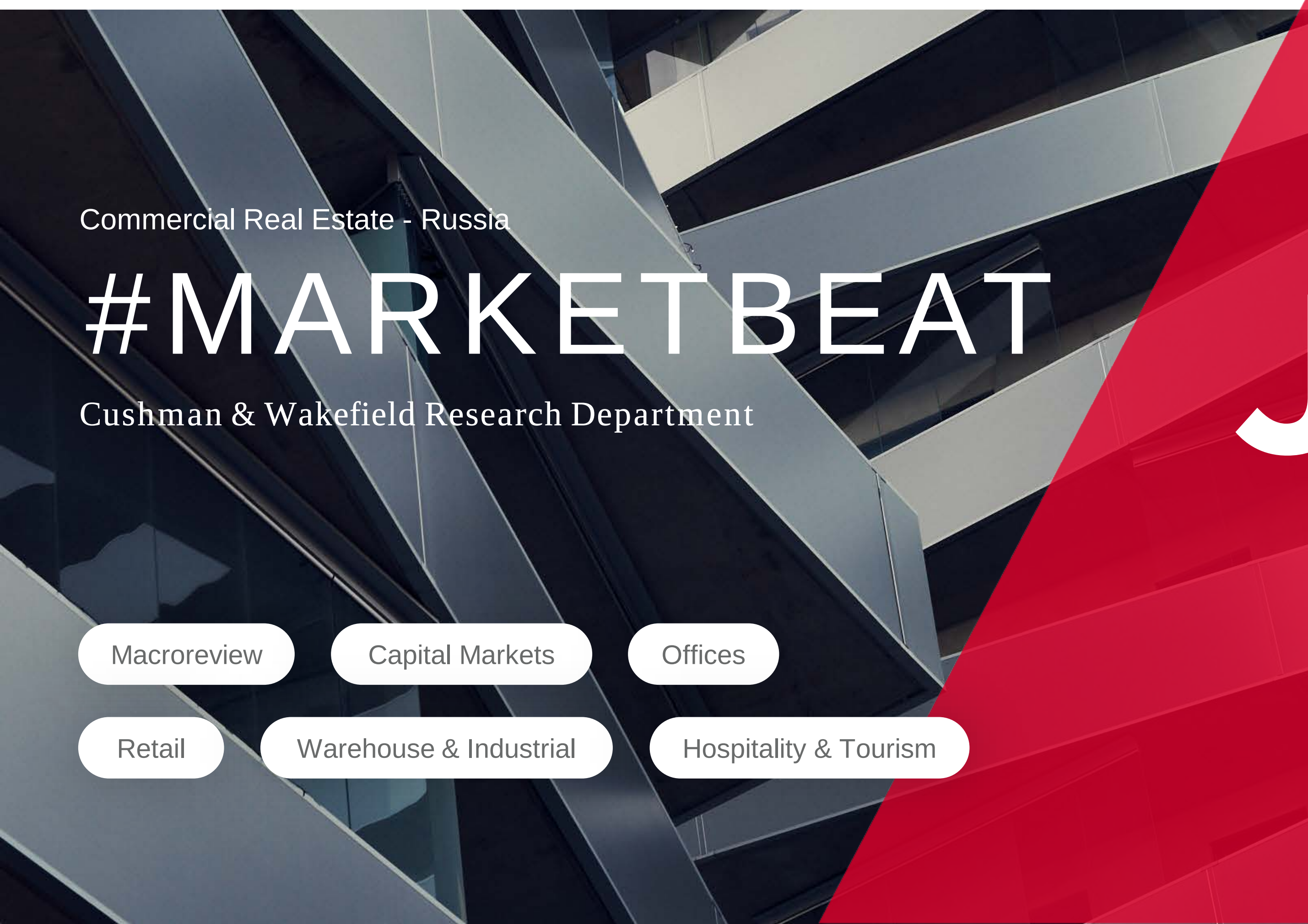


Commercial Real Estate - Russia

#MARKETBEAT

Cushman & Wakefield Research Department

Jan '18

Q4 | 2017

Macroreview

Capital Markets

Offices

Retail

Warehouse & Industrial

Hospitality & Tourism

Tip:
Click here to return to this page from any part of the document

CONTENTS

Tip:
Select a segment and click on it to go

Outlook

NEW REAL ESTATE CYCLE IN RUSSIA

After a 4-year recession the real estate market reached the bottom. We believe that in 2018 the market will turn to trend upwards. While the economy recovers at a slow pace, the real estate market will show anticipatory results.

Outlook

SUMMARY

2018 – a year of structural changes for real estate users.

In the beginning of 2018 presidential elections will be a major item on the agenda. There will be less economic news and fewer major initiatives.

However, people turned from 3 years of savings towards consumption. Growth in retail sales will drive demand for various types of commercial real estate.

The government will be rather conservative in setting the budget in order to achieve macroeconomic stability. Despite the fact that the Russian economy will underperform in comparison to the global economy, major real estate indicators will be in a green zone.

Russia now offers a unique blend of compressing yields and growing rents in relatively stable macro environment, This may attract foreign investors, but actual deals will be probably not happen before the end of the year.

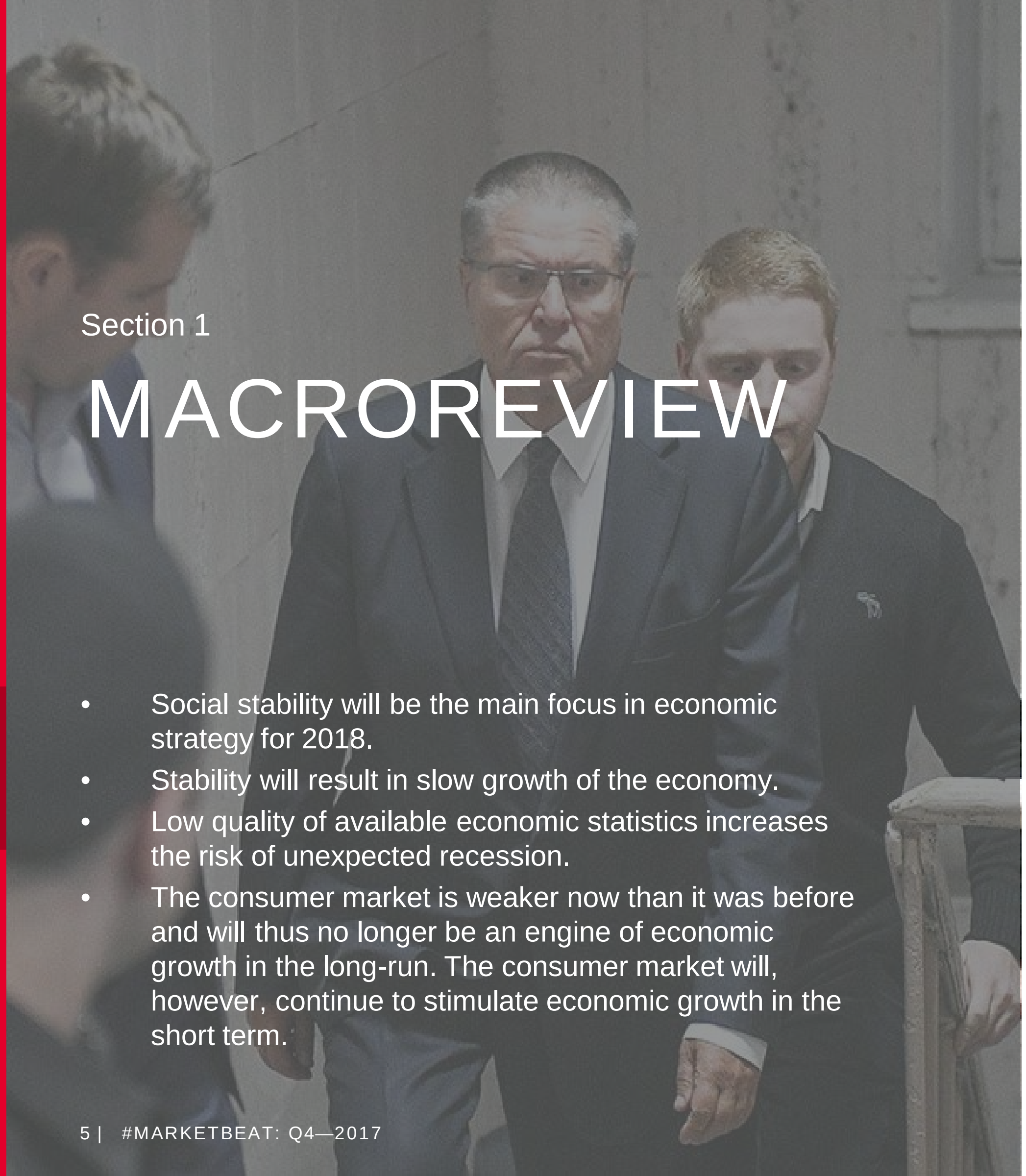
In 2017, the commercial real estate market had hit its bottom. Decreased rents facilitated transaction activities and office take up in Moscow reached almost 2 million square meters.

However, poor performance of the Russian economy in 2017 limited the growth of the value of real estate assets.

Major events occurred in the banking sector. The current round of banks bailouts is not yet finished and turbulence in the financial sector will lead to uncertainty in the real estate investment market.

In the coming years we will see structural changes among users of real estate space. Outperforming sectors will become drivers for retail and office demand.

The market starts warming due to structural changes in demand, but not a growth of speculative demand. Pricing spreads will continue growing, the difference in performance of successful and unsuccessful projects will become more noticeable.



Section 1

MACROREVIEW

- Social stability will be the main focus in economic strategy for 2018.
- Stability will result in slow growth of the economy.
- Low quality of available economic statistics increases the risk of unexpected recession.
- The consumer market is weaker now than it was before and will thus no longer be an engine of economic growth in the long-run. The consumer market will, however, continue to stimulate economic growth in the short term.

MACRO INDICATORS

	2017	2018	2019	2020	2021
GDP growth, %	1,7	1,8	1,4	**1,2**	1,2
RUB/USD	58,3	58,9	58,8	57,9	57,6
CPI, %	3,7	3,8	4,0	4,0	4,0
Interest rate	10,63	9,20	8,63	8,59	8,97
Current Balance, % of GDP	2,1	2,2	1,6	0,8	0,2
Private consumption, %	3,97	2,84	3,12	2,4	2,06
Government spending	-0,12	-0,27	0,6	0,71	0,81
Capital outflow, bn USD	4,32	53,47	65,76	70,51	78,57
Unemployment rate, %	5,23	5,26	5,21	5,14	5,09
BRENT crude oil price	53,7	60,5	62,5	64,5	67,8

Source: Oxford Economics 09/01/2018

THE ECONOMIC RECESSION IS OVER

Economic growth in 2018 will be driven mainly by the consumer sector which started growing again after a 3-year period of decline. However, neither personal income nor the condition of the retail sector suggest intensive growth. Thus, we predict a period of social stability and consumer market stagnation as opposed to a return to a consumer-driven economy.

1.8 %

GDP Growth forecast for 2018

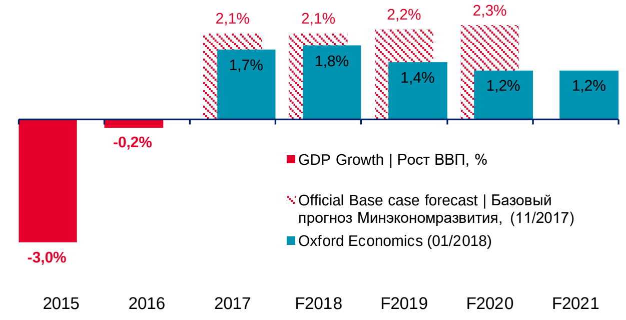
According to the Oxford Economics forecast

40 USD pb

Crude oil price forecast for 2018

Included in the base case scenario of the Ministry of Economic Development

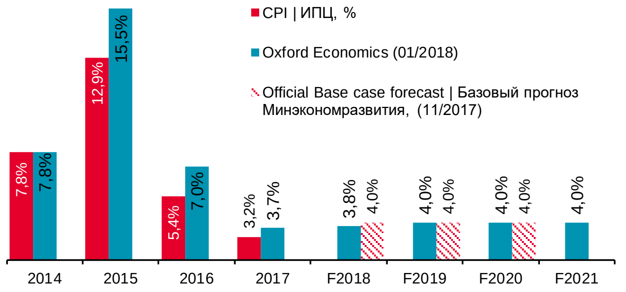
GDP Growth, %



The Russian economy has recovered after the crisis but remains rather unstable. Officials are now much more optimistic as compared to independent analysts, in particular in regards to the long-term outlook. But even base case forecast from the Ministry of Economic Development is based on an inertial scenario.

The budget is based on a conservatively low oil price. It means that the government will attempt to accumulate reserves to maintain stability and protect the economy from potential negative shocks.

Consumer Price Index, %



Low inflation is a challenge for the Russian economy as it has adjusted to high inflation over the past decade. High inflation expectations are built into a majority of business models across the different sectors of the economy. Companies favor immediate returns against long term profitability.

In addition, low inflation facilitates savings strategies among population, restricting the growth of sales.

Outlook

CONSUMER MARKET TRANSFORMATION

Household spending will stimulate the economy in 2018, while changes in the consumption structure will lead to an increase in the share of service industries. As a result, the efficiency of traditional anchor formats may be reduced. In addition, a new group of rapidly-growing industries will form. This group will include the financial sector, as well as the tourism, medical services, and public catering industries

CONSUMER MARKET - NEW ERA OF GROWTH

While the consumer market in general will grow in 2018-2027 at a slow pace, certain sectors including the medical and insurance services sector, the hospitality sector, as well as the public catering sector, will show anticipatory results. Traditional drivers of the consumer market (such as clothes, footwear, electronics) will have a minimal growth rate. This fact may lead to changes in the "anchor" functions in shopping centers.

75 %

Growth of consumer spending in general

2017-2027 (current prices, USD)

132 %

Growth of spending for medical services

2017-2027

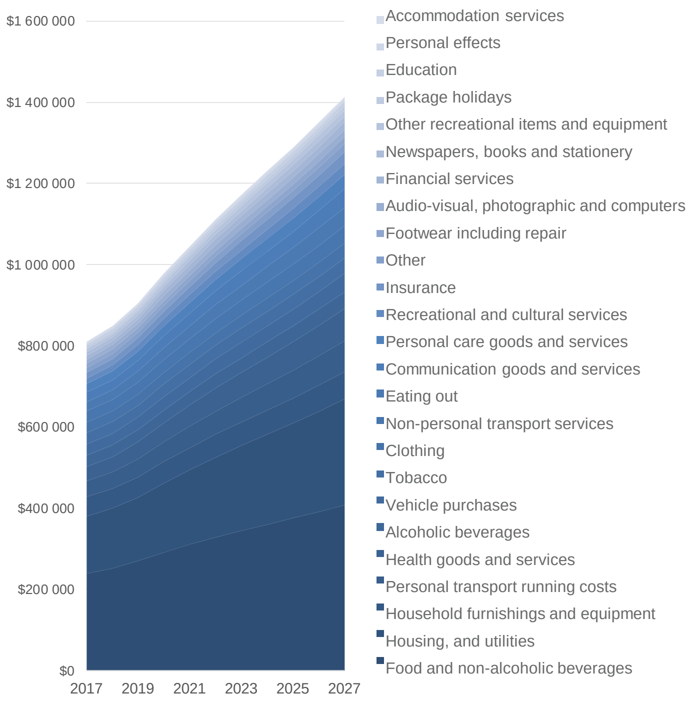
34 %

Growth of spending for clothing

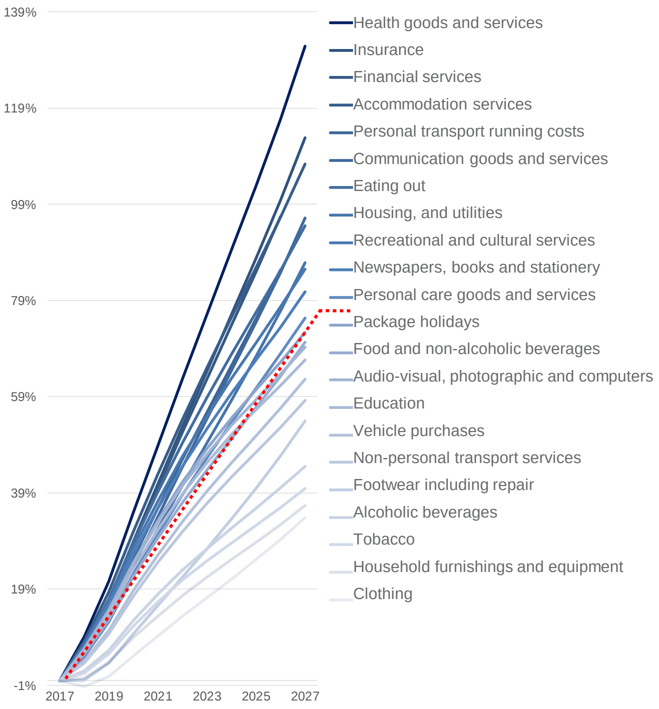
2017-2027

Source: Oxford Economics (Jan 2018)

Consumer spending dynamics and structure, mn USD



Consumer spending growth by category (progressive total)



HOUSEHOLD DEBT

By the end of 2017, Russian households shifted from a saving-driven model to consumption model which will become a driver of the retail turnover growth.

219 '000 RUB

Average per-household debt in Russia

Dec 2017

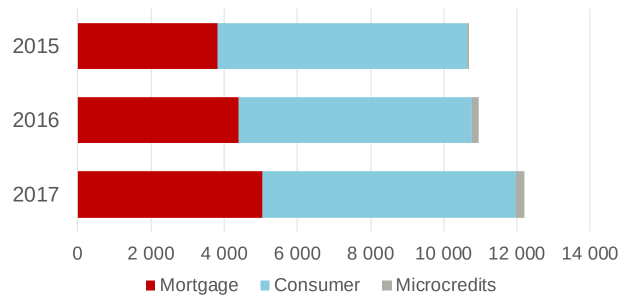
12 %

Household debt growth

Jan-Dec 2017

Source: The Central Bank of Russia

Household debt structure, bn RUB

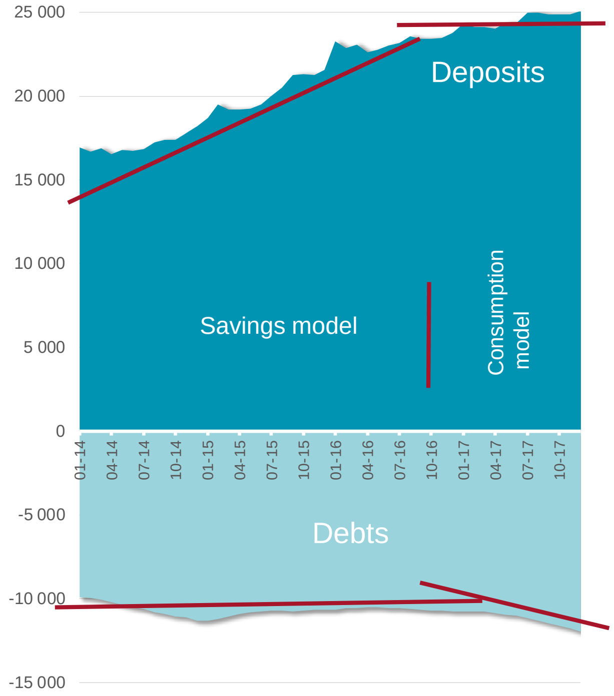


Source: CB, Cushman & Wakefield calculations

In 2017 household debt had increased by 12%. That includes 15% mortgage growth and 30% growth in microcredit non-bank loans. Non-bank loans is the fastest growing sector, but its share is still less than 2% of total household debt.

In Q4 2017 consumer debt started to grow after having decreased for the previous two years, indicating a shift in household behavior away from savings and toward greater spending.

Consumer credits and deposits, bn RUB



CORPORATE DEBT

Decrease of the key rate by 0.5 pp in December of 2017 and additional compression by 1 pp expected in 2018 will stimulate corporate debt expansion. The issue of bad debts will significantly evolve in the banking system in 2018.

7.75 %

Key Rate

By the Central Bank of Russia as of 18 Dec, 2017

23.2 %

Overdue Debt

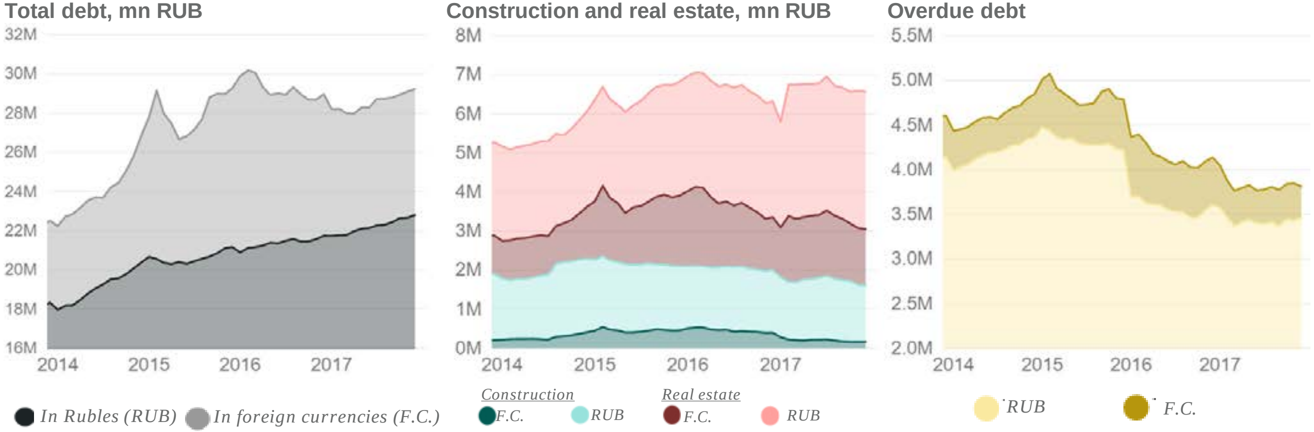
In Real Estate sector

Source: The Central Bank of Russia

Economy debt had recovered in second half of 207, however retail and wholesale trade along with real estate and construction are still under pressure, and experiencing a shortage of capital. In addition, the overdue debt rate is higher than average in theses sectors.

In construction, real estate and trade, the overdue debt rate reached 17%, 23% and 12% respectively in comparison with a 7% average overdue rate across the economy.

Corporate debt and overdue debt



PUBLIC RETAIL AND DEVELOPMENT COMPANIES

Stock exchange quotations vs MICEX index for the period 23.10.2017-19.01.2018

+2.3 %

Lenta

Leader by growth rate

-23.6 %

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

- The Russian investment market started to grow.
- Capitalization rates are decreasing following the trend of inflation and the Central Bank key rate.
- The share of foreign investments as a proportion of total investment volume is small.

4.06 bn EUR

Total investment volume in Russia

In 2017

4.5 bn EUR

Total investment volume in Russia

Forecast for 2018

10 %

Capitalization rate, prime office segment

Jan 2018

+27 %

Investment volume growth

In 2017

Capital Markets

INVESTMENTS GROW TOGETHER WITH YIELDS' COMPRESSION

The market structure will not change - local investors will still dominate the market. Implementation of state control over large commercial banks may lead to the increase of the number of assets offered for sale.

COMMERCIAL REAL ESTATE INVESTMENTS

Despite the negative political environment of 2017, the Russian investment market reported 27% growth indicating that the market has adapted to the repricing of the assets and the implementation of sanctions.

18.7 bn EUR

Investments in Central and Eastern Europe

Commercial real estate, 2017

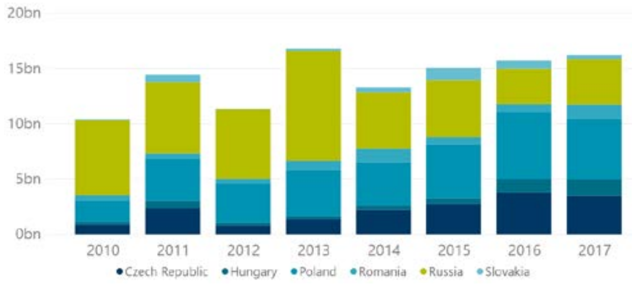
5.5 bn EUR

Investment volume in Poland

The largest investment market in CEE region

Source: Real Capital Analytics

Investments on the core CEE markets, bn EUR

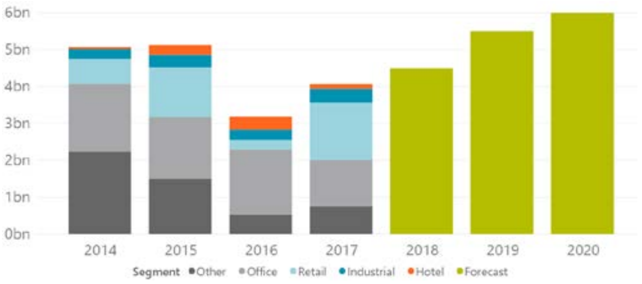


The real estate investment market in CEE has remained stable for 3 years at 18 bn Euro per year. 85% of investments are targeted at Poland, Czech Republic, Russia, Hungary, Slovakia and Romania.

Poland is a regional leader with 5.5 bn Euro. Romania represents the fastest growing market with a 64% growth rate in 2017.

Russia lost its leading position in 2016 but in 2019 we expect Russia to challenge the leader.

Investments in Russia, bn EUR



In 2017 investment volumes increased by 27%, however in comparison to the record year of 2013 when investment volumes hit 10 bn Euro the current market is still low.

n 2018 we expect minor growth in investment volumes. For the year 2019 our forecast is more optimistic - we predict a significant increase in investment volumes, reflecting an increase in the total number of transactions as well as growth in value.

CAPITALIZATION RATES

10.0 %

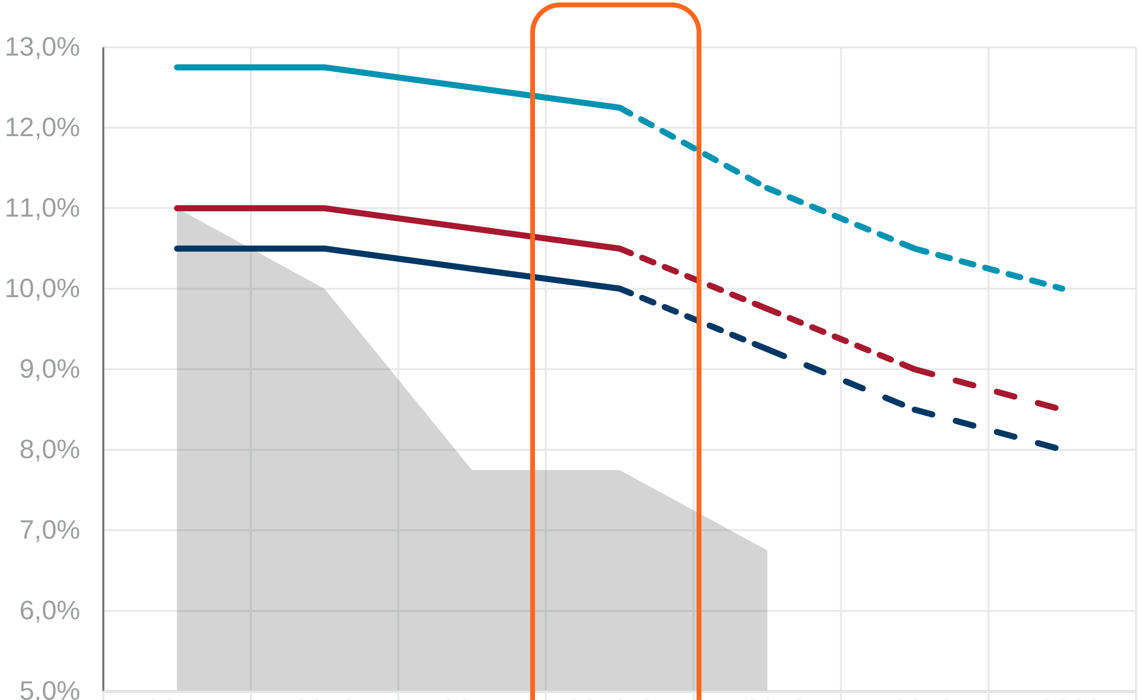
Office

Capitalization rate, Jan 2018

7.75 %

The key rate

The Central Bank of Russia



	2015	2016	2017	2018 Q1	F2018	F2019	F2020
Central Bank Key Rate	11,00%	10,00%	7,75%	7,75%	6,75%		
Office	10,50%	10,50%	10,25%	10,00%	9,25%	8,50%	8,00%
Shopping Centers	11,00%	11,00%	10,75%	10,50%	9,75%	9,00%	8,50%
Warehouse	12,75%	12,75%	12,50%	12,25%	11,25%	10,50%	10,00%

THE LARGEST DEALS IN 2017

Of the total investment volume in 2017, 25% is attributed to one deal - the Fort Group purchase of the Immofinanz portfolio of five shopping centers.

544 mn EUR

The largest deal in 2017

Golden Babylon Rostokino

901 mn EUR

Immofinanz portfolio

Buyer – Fort Group

Top 10 largest investment deals in 2017

Property	Buyer	Type	Date	Price, mn EUR
Golden Babylon Rostokino	Fort Group	Retail	7.12.2017	544,3
Gorbushkin Dvor	Viktor Kharitonin	Retail	5.6.2017	445,1
Nevskaya Ratusha	City of St Petersburg	Office	2.7.2017	213,6
GoodZone I and II	Fort Group	Retail	7.12.2017	177,5
Voentorg	Fosun Int'l Ltd	Office	11.1.2017	158
Leto City	RosEvroDevelopment	Retail	22.3.2017	155,1
Nagatinskaya Dev Site	Barkli Corporation	Dev Site	4.10.2017	132,3
Vasilievsky Island	LSR Group	Dev Site	19.7.2017	111,3
Legion II (phase 2)	UFG Real Estate	Office	31.3.2017	97,7
Golden Babylon Ortradny	Fort Group	Retail	7.12.2017	81,4

Source: Real Capital Analytics

INVESTMENT STRUCTURE

The share of foreign investments in Russia is still low and the situation will most likely remain unchanged in the coming years.

77 %

The share of foreign investments

The Central and Eastern Europe

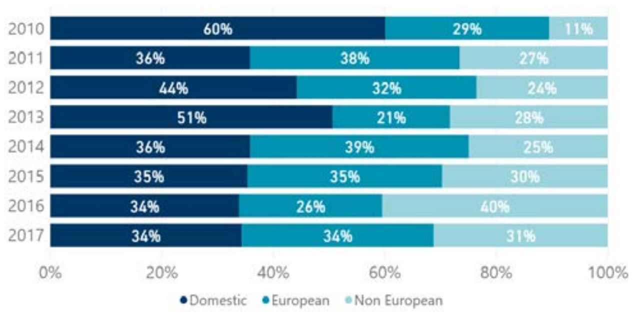
14 %

The share of foreign investments

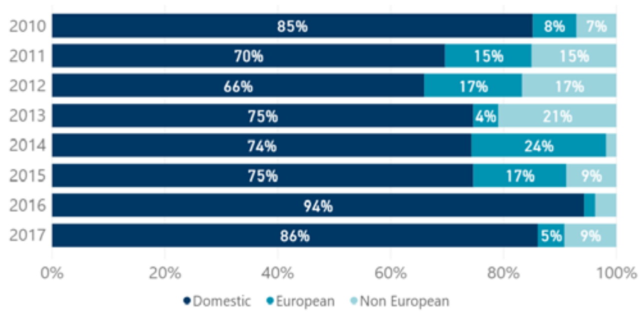
Russia

Source: Real Capital Analytics

The Central and Eastern Europe



Russia



CEE investment capital is evenly distributed among domestic, European and non-European investors. In the long term non-European investments will grow at the fastest rate as CEE markets are opening to capital from Asia, Americas and Africa.

In Russia domestic investors have dominated since 2009. We expect that the share of foreign investments will increase but that will still remain below 20% until the Russian economy becomes less risky for foreign capital.

Section 2

OFFICES

- Despite the fact that the majority of indicators in Q1-3 2017 lagged behind those of 2016, by the end of 2017 the situation flattened out.
- The office real estate market is at the bottom.
- In 2018, we expect a slight increase in rental rates based on the inflation rate and a washing out of the best offers from the market.

Moscow 2017 Class **A**, **B+** & **B-**

16.86 **mn sq. m**

Total stock of office buildings 01/01/2018

408 **'000 sq. m**

Construction

-54 **'000 sq. m**

Net absorption

1.9 **mn sq. m**

Take-up

Offices

In 2018, we expect a low increase in rental rates on the background of relatively low activity

Real estate is the main source of reducing costs for companies facing growth in production costs and contraction of consumer demand.

VACANT OFFICE PREMISES

In 2018-2020, we expect a decrease of available vacant premises in class A.
In general, the vacancy rate is stable (in classes A, B + and B-).

12.5 %

Vacancy rate
January 2018

2.1 mn sq. m

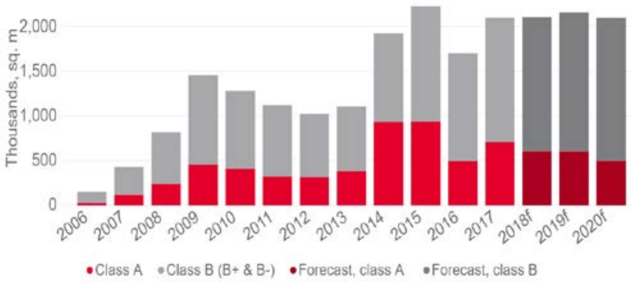
Vacant premises
January 2018

Source: Cushman & Wakefield

Vacancy rates

Due to stably low new construction in 2017 and record high take-up over the last 5 years, the vacancy rate declined by the end of the year and will stay at its current level in 2018.

Vacant premises



The area of vacant premises exceeded the indicator from 2016 given the negative absorption and high new construction in Class A.

There are office premises of different areas and conditions in both class A and B properties in almost all districts across Moscow. However, the closer a particular location is to the center, the lower the vacancy rate is registered.

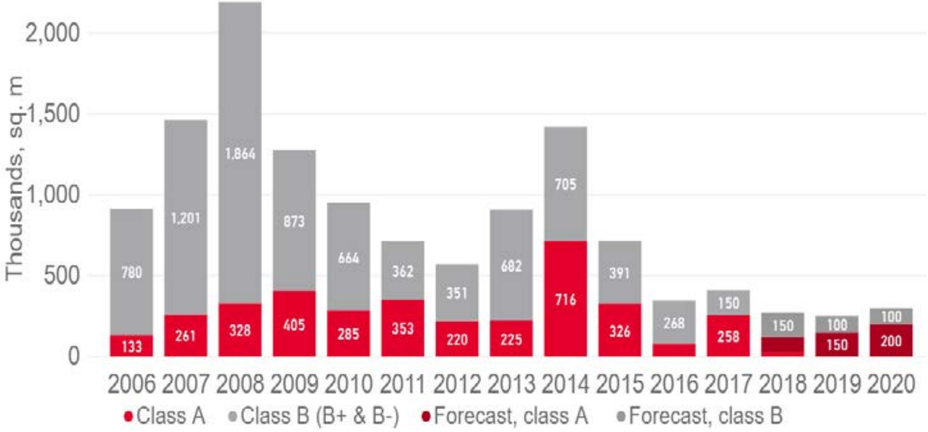
NEW SUPPLY

In 2017, almost all previously-postponed projects from 2015 - 2016 were completed. We expect new construction to decrease in the period 2018-2020.

New construction in 2017 was relatively high and amounted to 408,000 sq. m, in 2018 the figure will remain stable. 2019 will be accompanied by a slight improvement. In 2018 - 2020 we expect lower levels of construction activity, with 1 mn sq. m of new office space to be constructed during the next 3 years, and thus, as a result, lower vacancy levels.

As expected, by the end of 2017, the total volume of new construction amounted to 408,000 sq. m – 240,000 sq. m of that volume represents the area of two towers in the City submarket. Four office buildings were delivered into the market, one of which was occupied immediately upon the market entry.

New construction, class A and B



ABSORPTION RETURNS TO THE POSITIVE ZONE

In H1 2017, there was a high negative absorption, however, in Q4, the situation recovered and demand for additional office premises will continue to increase.

-54 **'000 sq. m**

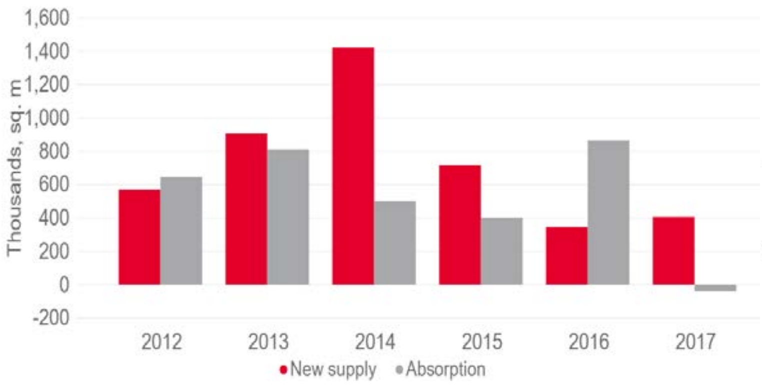
Absorption in Q1-4 2017

408 **'000 sq. m**

New construction in Q1-4 2017

Source: Cushman & Wakefield

Absorption and new construction



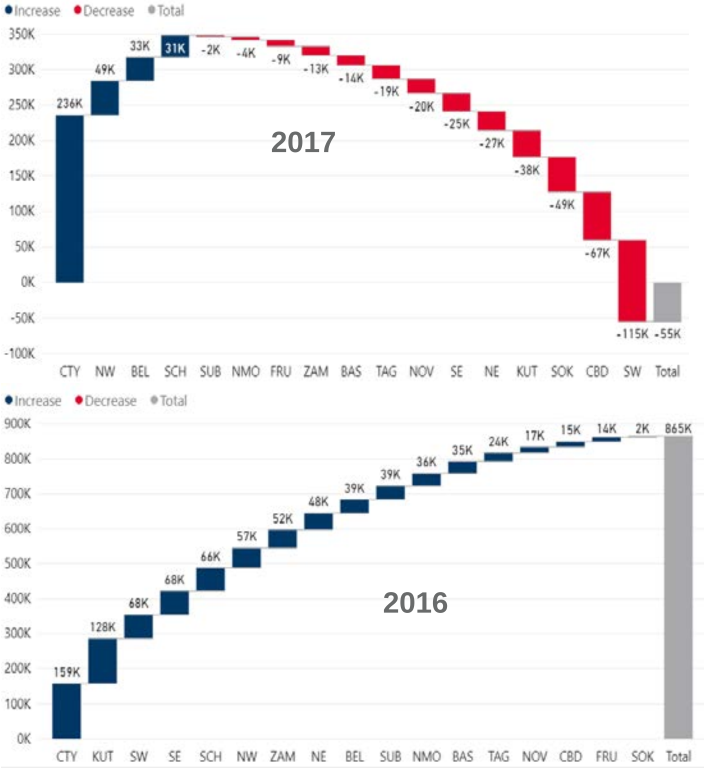
Absorption by class

ABSORBTION BY SUBMARKETS

Moscow City represents the area of highest demand in Moscow in 2017.

The most demanded submarkets in Moscow in 2017

Absorption by submarkets



In 2017, the reduction of office area or the shift to higher-quality office buildings is apparent. While many submarkets became less attractive, central locations such as Shabolovsky, Belorusskiy and the City submarket reported an increase in demand.

The most attractive submarket is the City. Q4 was associated with a a large impact on positive absorption in the City submarket in 2017. Supply increased by 239,000 sq. m while and the vacancy rate remained at the same level due to high demand. Thus, as soon as new quality areas at good prices and conditions in the City submarket were delivered into the market, demand immediately moved into equilibrium with supply.

DEMAND

Record high demand for office premises returned to pre-crisis indicators.

1,910 '000 sq. m

Take-up (lease and sale deals)

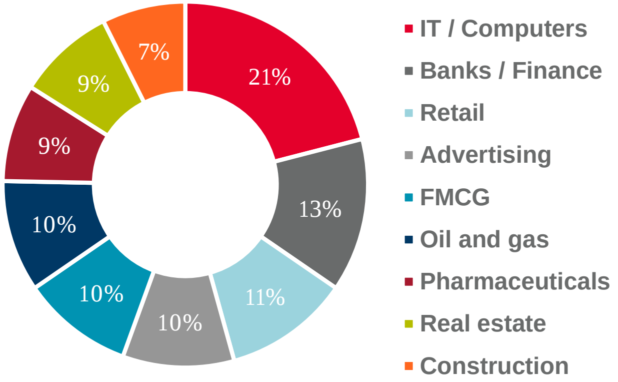
Q1-4 2017

Source: Cushman & Wakefield

Major deals in 2017

COMPANY	AREA SQ. M	PROPERTY	CLASS /SUBMARKET	TYPE OF DEAL
Gazprombank	*43,364*	*Aquamarine III*	*A / Downtown*	*Sale*
Auction LLC	*38,317*	*Poklonka Place*	*B+ / Central*	*Lease*
VimpelCom	*17,004*	*Bolshevik 2-nd phase*	*A / Downtown*	*Lease*
Tele2	*13,053*	*ComCity*	*A / OTA*	*Lease*

The most active industries by closed deals in 2017



In Q1-4 2017, 2900 new deals were executed totaling 1.91 mn sq. m. Record high demand indicated a return to pre-crisis indicators of 2012 due to big deals by state corporations, a favorable environment at the lower end of the market and the fact that tenants complete their move by terminating 5-year agreements, using opportunities of the low market.

15 % of take-up in Q1-4 was carried out through the purchase of entire buildings and the lease of big blocks in business centers (>5,000 sq. m deals).

The most active industries in 2017 were IT and Computers (21%), Banks and Finance (13%) and Retail (11%).

After record high levels in 2017 we expect slight decrease in take-up in 2018, and continued stability in 2019.

Offices

LEASE DEALS IN MOSCOW

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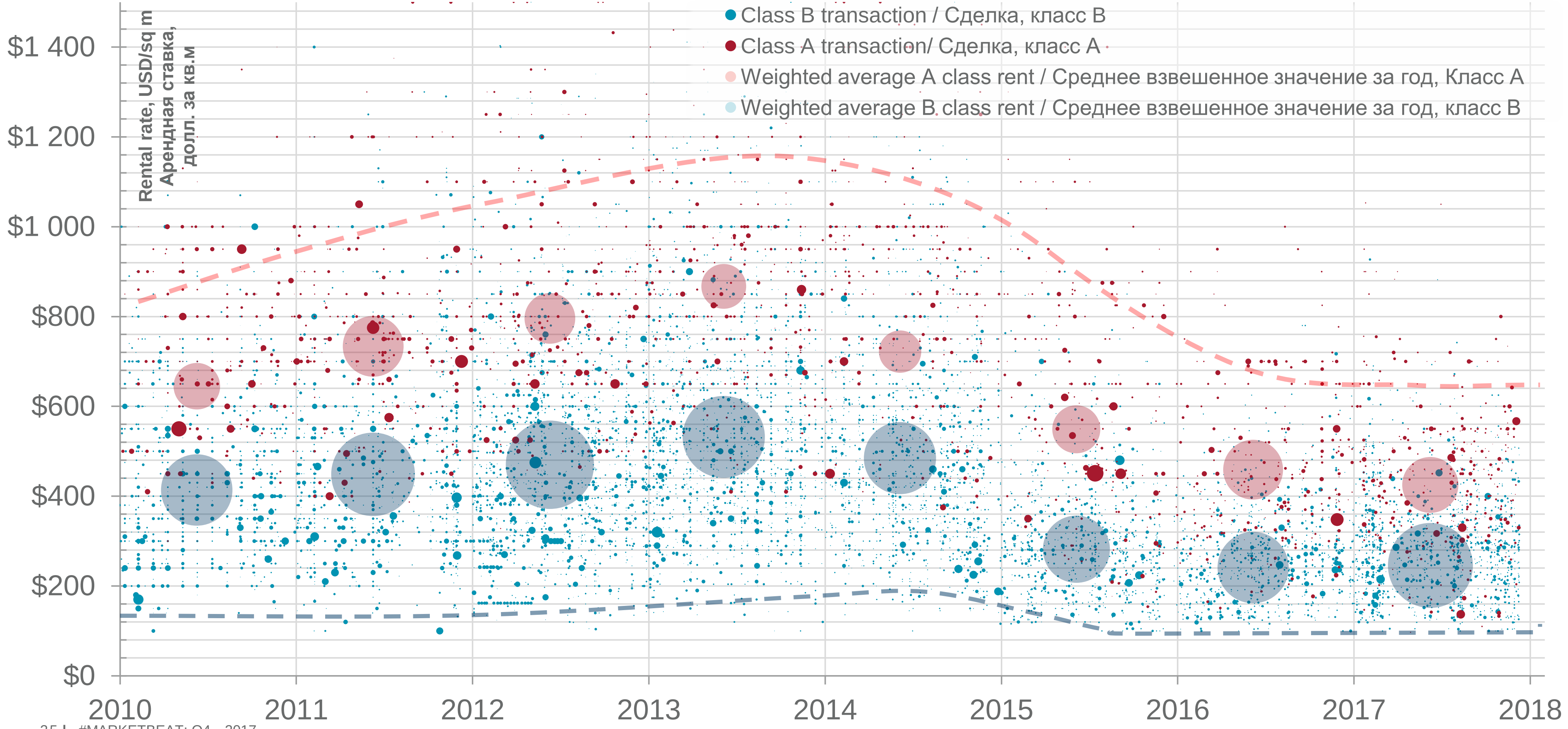

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RENTAL RATES

Forecast for a gradual increase in rental rates at the indexation level.

434 USD / sq. m annum

December 2017

Dollar equivalent (all deals in class A)

14,411 RUB / sq. m annum

December 2017

Ruble equivalent (all deals in class B)

Source: Cushman & Wakefield

Rental rates in US dollars value

Average ruble equivalent of rental rates in 2017 is 17,848 Rubles/sq. m/year. We expect a small increase in rental rates.

The average dollar equivalent of 2017 rental is 307 USD/ sq. m/year. This represents a record minimum rental rate for office premises in Moscow.

Rental rates in Russian rubles value

In 2018-2020, we expect an increase in rental rates at the indexation level due to a stable ruble exchange rate and no economic prerequisites for speculative market growth.

RENTAL RATES

Share of lease deals in foreign currency reached the minimum (the indicator is gradually decreasing: 98% in 2014, 18% in 2015 and down to 7% in 2017). Share of USD lease deals in class B amounted to barely 1.2%, while in class A it was 23%. The number of USD lease deals in class A increased relative to the indicator of 2016 (18%).

23 %

Share of USD lease deals

Class A

7.6 %

Share of USD lease deals

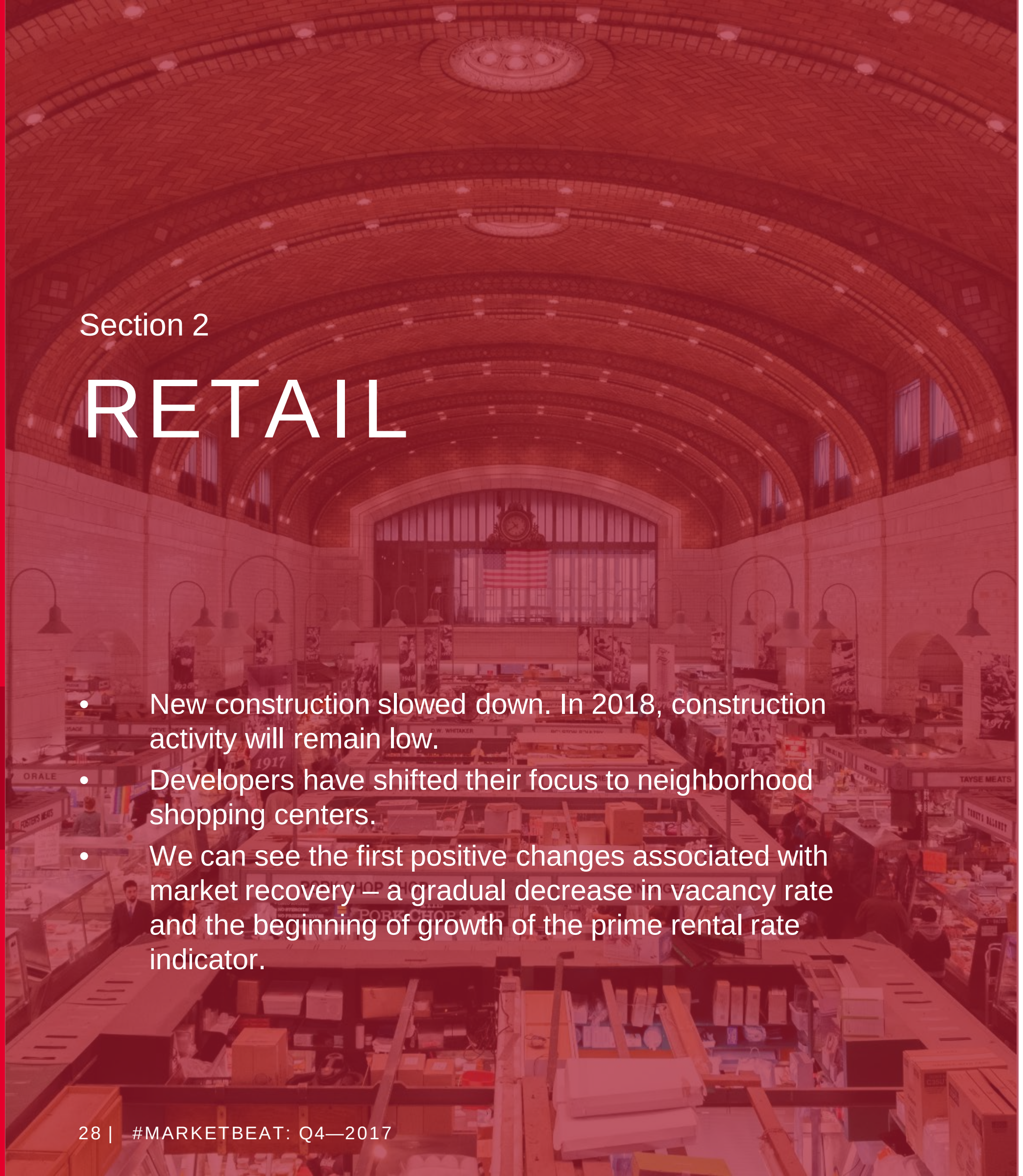
To outperform the market

Source: Cushman & Wakefield

Leasing demand and rental rates

Leasing demand and rental rates

Class	*Deal currency*	*Deals volume, sq. m*	*Rate*
A	*USD*	*129,931*	*$551*
	RUB	*409,032*	*22,919 rubles*
B+ & B-	*USD*	*14,838*	*$403*
	RUB	*1,223,662*	*14,312 rubles*



Section 2

RETAIL

- New construction slowed down. In 2018, construction activity will remain low.
- Developers have shifted their focus to neighborhood shopping centers.
- We can see the first positive changes associated with market recovery – a gradual decrease in vacancy rate and the beginning of growth of the prime rental rate indicator.

5.1 mn sq. m

Total quality stock

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

135 '000 sq. m

New construction, Moscow, 2017

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

9.4 %

Vacancy rate

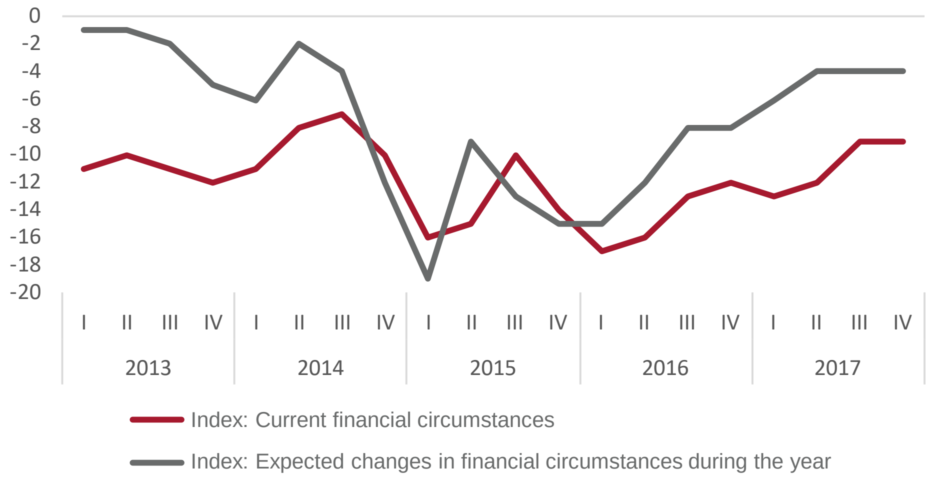
Quality shopping centers, Moscow

150 '000 RUB / sq. m

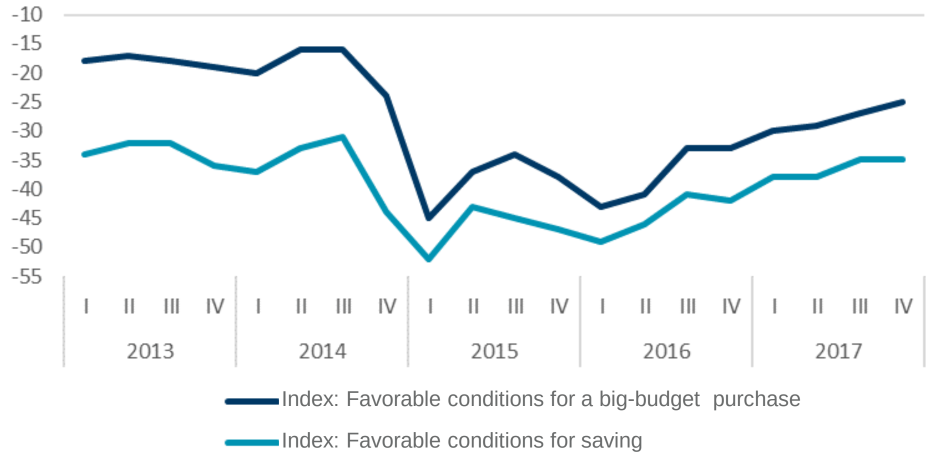
Prime rental rate indicator

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

Customers evaluate their financial circumstances



Customers evaluate preferences: spending vs saving



Retail

CONSUMER CONFIDENCE INDEX IS RECOVERING

Consumer confidence is close to the pre-crisis level, however customers are still adhering to the savings model.

The consumer confidence index has almost reached its previous level from the end of 2013. Customers are now much more positive about their current financial situation and optimistic about potential changes in 2018.

However, in 2017, the consumer market was shrinking. If a consumer had the choice to save money or to make a big-budget purchase, he would rather choose the first option. The index of “favorable conditions for money saving” is back to its 2012-2013 level, while the index of “favorable conditions for a big-budget purchase” remains at a low level.

At the end of 2017, we can see a gap in the tendency to shop, prerequisites that serves as the early indicator for the positive change in retail sales. However, in 2018, rapid growth is not expected.

CONSUMER MARKET RECOVERY

The pace of consumer market recovery is proceeding according to expectations.

Forecast for 2018

2.9 %

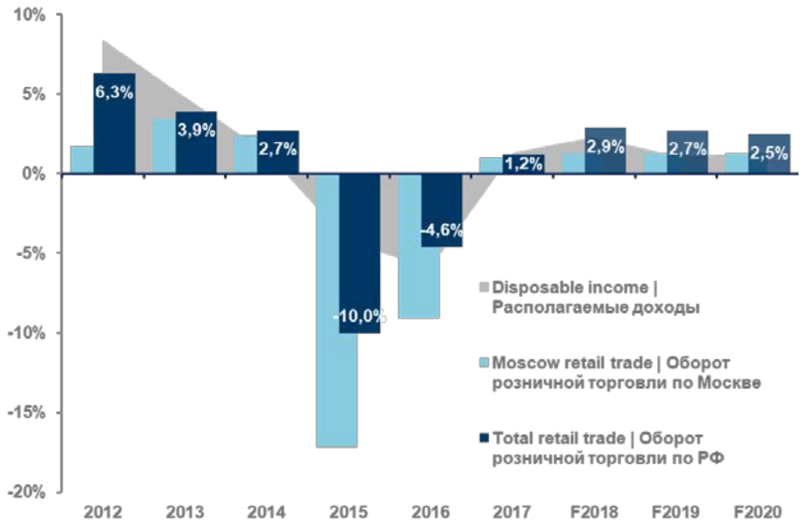
Retail turnover growth

2.3 %

Disposable income growth

Source: The Ministry of Economic Development forecast (09/2017)

Consumer market indicators



Source: The Ministry of Economic Development

In January-November 2017, the retail turnover growth in Russia was 1%, which fits the previous forecast of the Ministry of Economic Development. Therefore, the new forecast review did not bring any changes.

The forecast for the consumer market in Moscow at the end of the last year was revised downward both for retail sales and real disposable income. The estimated growth for these indicators varies at around 1% for the previous year and for the 2-year perspective.

Retail

FROM QUANTITY TO... OPTIMIZATION

New construction is decreasing, developers are taking a new look at the concepts of shopping centers, and retail chains are analyzing the changing consumer experience.

RECORD LOW CONSTRUCTION VOLUME IN 2017

The decrease in new construction is observed in both Moscow and Russia overall. In 2017, the construction volume reached the lowest level in the previous 10 years, half of the reported figure from 2016.

616 **‘000 sq. m**

New construction, 2017

Russia (including Moscow)

135 **‘000 sq. m**

New construction, 2017

Moscow

Source: Cushman & Wakefield

Central Park – Phase 2

Kursk, GLA – 107,000 sq. m

The largest shopping center opened in the regions of Russia.

In 2017, 16 retail schemes with a total GLA of 616,000 sq. m were delivered to the market in Russia.

Developers are more focused on renovation and extension of existing properties instead of new construction. The biggest share of new construction volume (almost 60%) is composed of the new phases of already existing projects.

The largest shopping center opened in 2017 in Russia was Vegas Kuntsevo (GLA 119,467 sq. m), located in Moscow.

Among regional projects, the biggest opening was the second phase of the Central Park shopping center (GLA 107,000 sq. m), located in Kursk.

THE MARKET IS REACHING MATURITY

The retail real-estate market in Russia has passed through the phase of active growth and “weight gain”. The construction of new retail schemes does not affect the market as much as it did before.

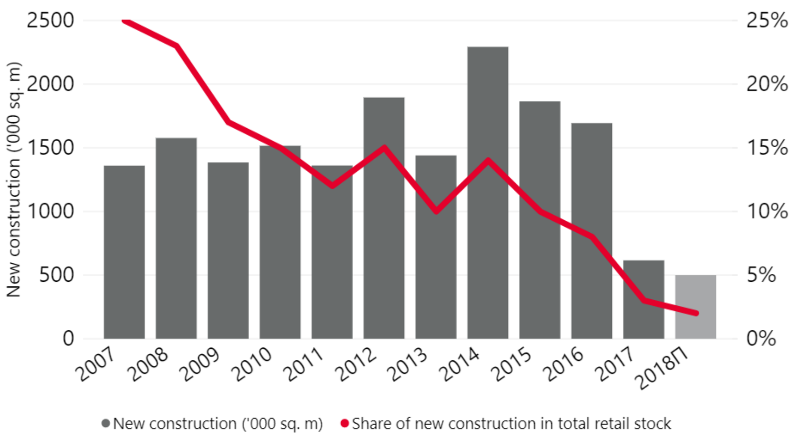
21 mn sq. m

Total quality retail stock, Russia (including Moscow)
as of January’18

0.5 mn sq. m

New construction, Russia (including Moscow)
Forecast for 2018

New construction in Russia (including Moscow)



Source: Cushman & Wakefield

Starting from 2016 the share of new construction is less than 10% of the existing stock.

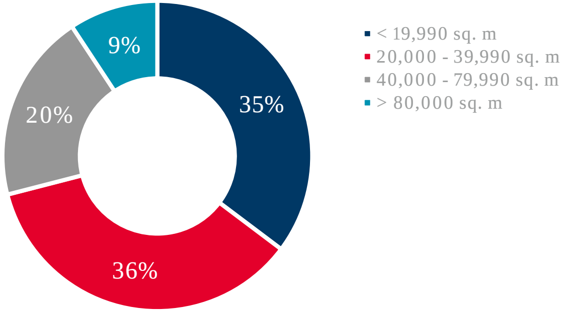
Developers are focused on their existing portfolios, thus, they organize activities targeted to footfall increase, optimize concepts, and search for new formats and approaches to business operations.

The era of super regional and regional malls is over. The growth in this segment is expected to be organic (achieved through the extension of existing mid-size and large-scale properties). The construction of neighborhood and community shopping centers is an optimal strategy given existing market conditions – small areas are quickly absorbed by tenants, day-to-day purchases are stable in crisis periods and do not compete with fast-growing online sales. The same approach is demonstrating its success in more developed markets. For instance, community centers in the United States represents the most actively growing segment in recent years.

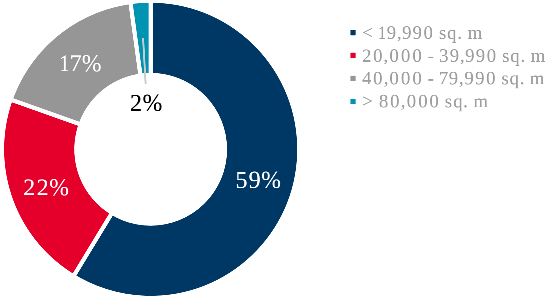
MARKET STRUCTURE BY FORMAT OF THE RETAIL SCHEME

BY QUANTITY

Existing

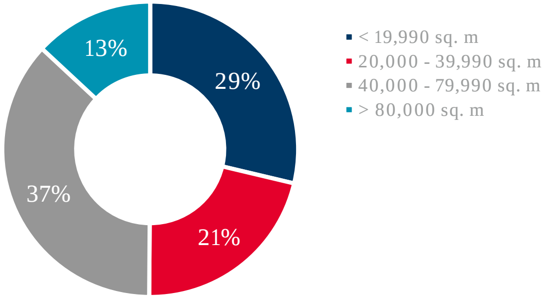


Planned for 2018

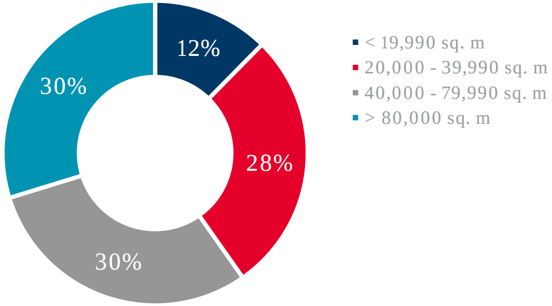


BY AREA

Existing



Planned for 2018



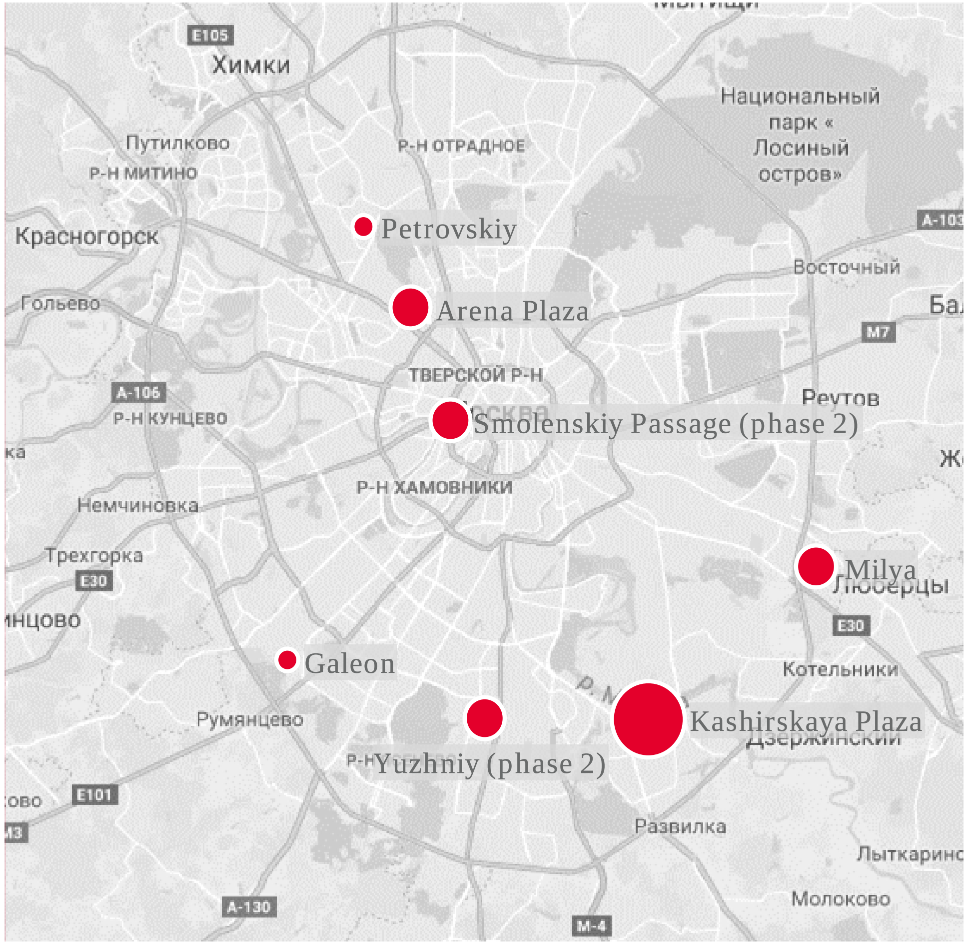
The average size of the existing retail scheme is currently 36,800 sq. m, while the average size of a shopping center planned for delivery in 2018 is only 28,500 sq. m.

Analyzing the structure of the pipeline for 2018, it is evident that developers have shifted their focus from large-scale projects to smaller size schemes.

The share of neighborhood shopping centers with GLA of less than 20,000 sq. m shows the most dynamic growth both by quantity of projects and by total area. The main idea is making shopping more convenient and close to customers.

Retailers as well as developers have followed the recent market trends by developing mini-formats (Moy Auchan, AV Daily, Detskiy Mir, Leroy Merlin etc.).

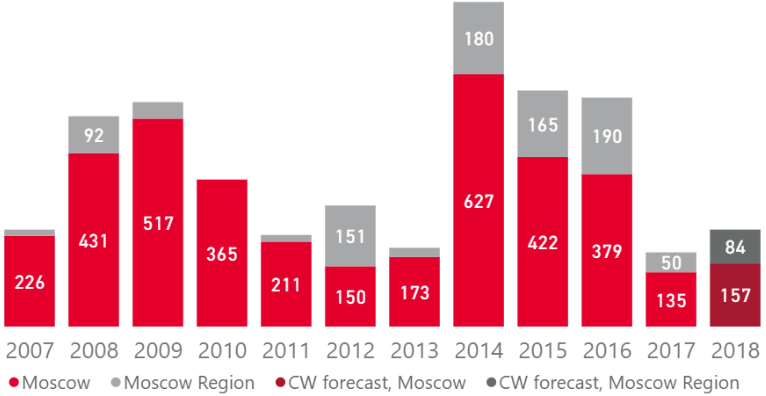
Shopping centers planned for delivery in Moscow in 2018



Retail

NEW CONSTRUCTION IN MOSCOW

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



The rebound of new construction is not expected in the next two years. Mostly small shopping centers and around 1-2 large-scale schemes will be constructed annually.

In 2018, new construction will maintain its 2017 level. Kashirskaya Plaza (GLA – 71,000 sq. m) is the only large-scale shopping center that will be delivered to the market next year.

RETAILERS ARE LOOKING FOR NEW FORMATS

Large operators continue moderate expansion. Grocery stores are the most active market players.

Eataly Food hall, Kievskiy shopping center

Food halls have been a relatively new format for the Russian market are in fact actively developing now. 8 new concepts were opened in Moscow during the last three years, and more and more new projects are being announced, including projects in the shopping centers (Pyataya Avenue, Nikolskaya Plaza, Zolotoy Vavilon shopping centers). Food halls are traffic generating tenants and they are considered to be new points of attraction for shopping centers.

Grocery stores, that used to have diversity of formats (hypermarket, supermarket, discounter, convenience store) are focusing on the most successful ones in terms of continued business optimization. For instance, Okey sold its supermarket format shops, and X5 Retail Group put up the Perekrestok Express stores for sale.

Russian brands are announcing plans for international expansion, including Leonardo, DoubleB, Tashir Pizza, Gulliver, and Alex Fitness.

NEWCOMMERS, Q4 2017

МУЛЬТ

UNDER ARMOUR

3 I N A

Disney

MAUBOUSSIN

De Beers

Several international retailers that entered Russian market in 2017 have begun active expansion – Miniso (Japanese brand) announced plans to explore the regions of Russia and to open up to 100 shops by 2019; Under Armour opened up stores outside of Moscow in both St. Petersburg and Ekaterinburg.

COMMERCIAL TERMS

2017 was a period of stabilization for the retail market. In general, commercial terms remained stable, however the prime segment showed the first signs of growth reflecting the strengthening confidence of market players.

150 '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 *

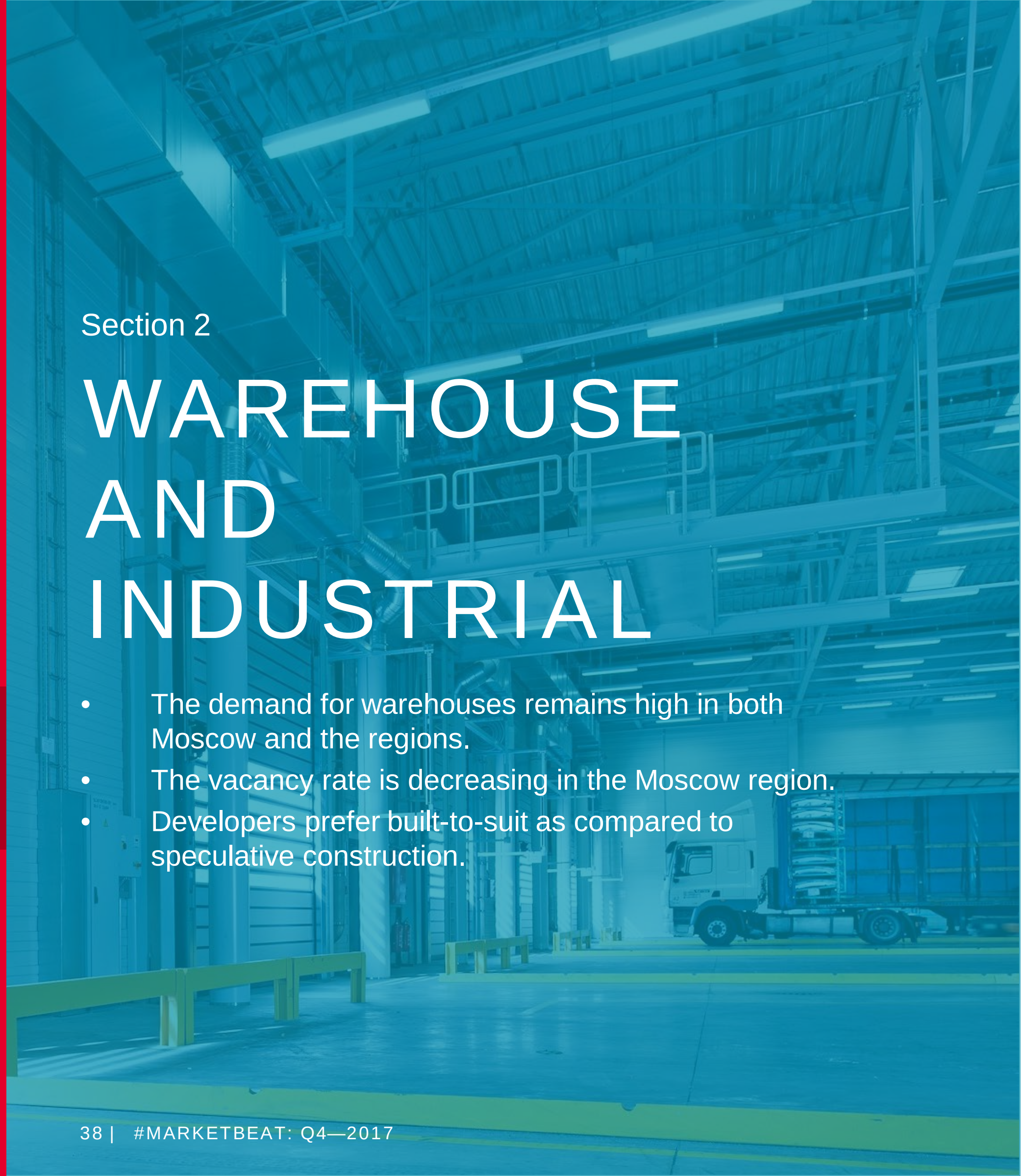
	Average rental rate, rub./ sq. m / year	
TENANT TYPE	MIN	MAX
Hypermarket	-	8 000
DIY	-	10 000
Entertainment center	-	14 000
Cinema	6 000	12 000
Fashion (anchor)	-	15 000
Retail gallery unit	20 000	180 000
Fitness center	6 500	10 000
Restaurant, café, coffee shop	20 000	100 000
Food court	75 000	150 000

Source: Cushman & Wakefield

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

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 categories of tenants also pay fixed rent.

Average percentage varies from 12 to 15% for retail gallery operator, from 3 to 5% for large anchor tenants.



Section 2

WAREHOUSE AND INDUSTRIAL

- The demand for warehouses remains high in both Moscow and the regions.
- The vacancy rate is decreasing in the Moscow region.
- Developers prefer built-to-suit as compared to speculative construction.

MOSCOW, CLASS A

	2017	**2018 (forecast)**
Stock (‘000 sq. m)	9,911	10,581
New construction (‘000 sq. m)	410	670
Vacancy rate (%)	9.5	9
Rental rate * (RUB / sq. m / year)	3,300	3,300
Take up (‘000 sq. m)	1,203	1,200

REGIONS, CLASS A

	2017	**2018 (forecast)**
Stock (‘000 sq. m)	6,653	7,023
New construction (‘000 sq. m)	360	396
Take up (‘000 sq. m)	607	600

** Average rent excluding OPEX, utilities and VAT*

DEMAND FOR WAREHOUSE SPACE IS STABLE

Trends. Moscow and Regions

770 ‘000 sq. m

New construction, class A

Moscow and the regions, 2017

1,810 ‘000 sq. m

Take up, class A

Moscow and the regions, 2017

Source: Cushman & Wakefield

2017 became a turning year for the market in Moscow. The demand was consistently high in H2 of 2017, so the vacancy rate started to decrease and the average rental rate stopped falling. These factors had a positive impact on developers’ activity. New projects were announced. However, the construction will not be speculative – preliminary lease or purchase agreements will be signed.

In 2018, the trend will remain the same. If demand remains stable, the critical growth of the rental rate as well as the decrease in the vacancy rate are not expected to occur. The market will remain the market of the tenant, who is ready to wait until a suitable warehouse in a preferred location is constructed, rather than leasing space in some old inconveniently located warehouse complex.

In the regions we also see the focus on built-to-suit. Since 2016, the pace of speculative construction has slowed down and rental rates have stabilized. In St. Petersburg, there was a lack of warehouse space, so rental rates in this region were higher than in Moscow.

In the short term, both in the regions and in Moscow the trend will remain the same with less speculative construction. Developers will prefer to start construction after signing lease or purchase agreements. The rental rate will remain stable, and the vacancy rate will decrease slightly.

Warehouse & Industrial

MOSCOW REGION

The vacancy rate is decreasing amid a background of decreased rental rates and construction activity.

THE VACANCY RATE IS DECREASING

Rental rates and the vacancy rate. Moscow region

9 %

Vacancy rate, class A

2017

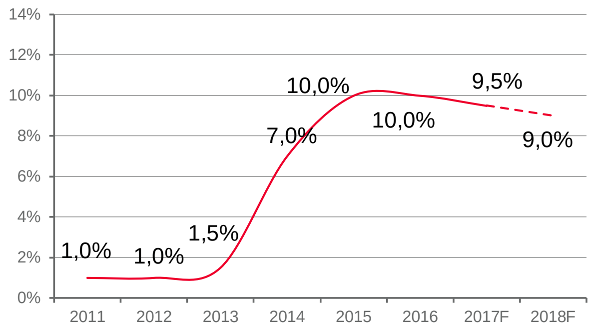
3,300 RUB / sq. m / year

Rental rate, class A

2017

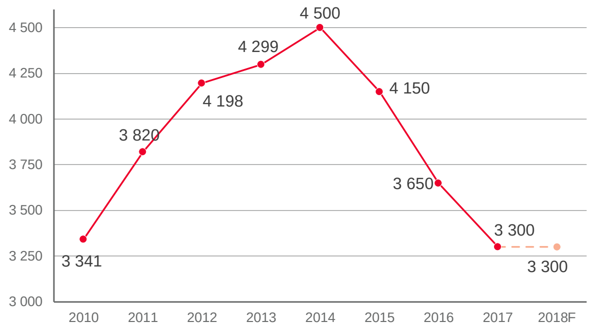
Source: Cushman & Wakefield

Vacancy rate, class A



In Q4, the vacancy rate in the Moscow region went down. Developers are giving up speculative construction and focusing on built-to-suit. The vacancy rate is decreasing amid a background environment of high demand. In 2018, the vacancy rate will continue to decrease, however the drop won't be severe. In the Moscow region there are many well-located land plots suitable for built-to-suit construction and customers are prepared to wait to obtain the warehouse that fully meets their requirements, so existing properties still remain not occupied.

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



In 2017, the average rental rate was 3,300 rub. / sq. m / year, which is 10% lower than in 2016. We do not expect any rental rate fluctuations in 2018. For some of the major developers these rates are satisfactory.

NEW CONSTRUCTION DECREASED IN 2017

Supply. Moscow region

463 **‘000 sq. m**

New construction, class A and B

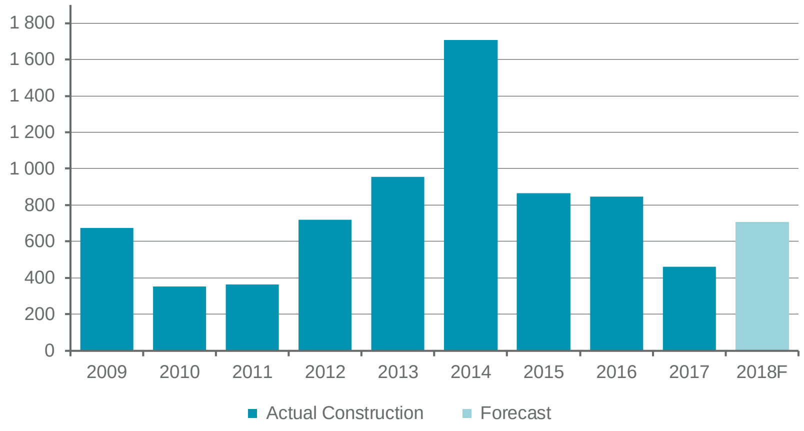
2017

703 **‘000 sq. m**

New construction, class A and B

Forecast for 2018

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



Source: Cushman & Wakefield

In 2017, 463,000 sq. m of warehouse space was delivered to the market, which is 45% lower than the same indicator in 2016. In Q4 of 2017, the construction volume was 185,000 sq. m, which is 40% of the total annual amount.

Low rental rates and high vacancy level failed to stimulate developers to finish the properties that were currently under construction and start the development of new projects. The situation improved in Q4 of 2017, when the vacancy rate started to decrease.

In 2018, we expect new construction to grow. In the Moscow region, around 700,000 sq. m of quality warehouse space will be delivered to the market. 60% of this new space is already pre-leased or pre-sold.

WAREHOUSE SUPPLY IS CONCENTRATED IN THE SOUTH-EAST

Supply. Moscow region

9.9 **mn sq. m**

Stock, class A

2017

10.5 **mn sq. m**

Stock, class A

Forecast for 2018

Source: Cushman & Wakefield

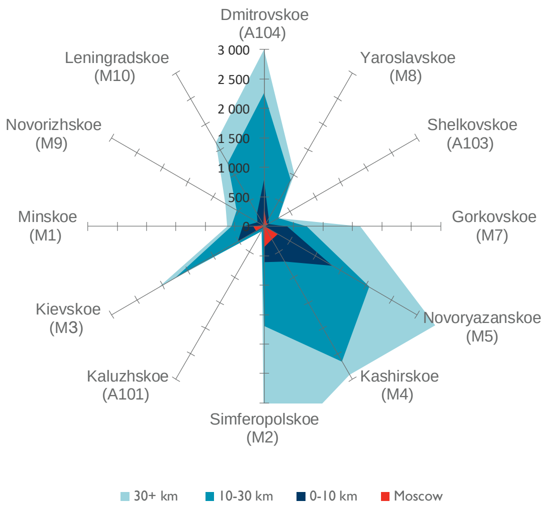
Top 3 directions by W&I supply

Highway	Share	Area, '000 sq. m
Simferopolskoe	18.9%	4,047
Novoryazanskoe	15.7%	3,357
Dmitrovskoe	14%	3,001

Source: Cushman & Wakefield

Geographical distribution in the Moscow region has been stable for several years, however some changes are possible in mid-term perspective. There are several reasons for these changes: the end of the first phase of reconstruction of Gorkovskoe, Kaluzhskoe, and Yaroslavskoe highways; the decline in land prices for industrial and logistics construction; the reconstruction of the road network between the Third Ring Road (TTK) and Moscow Ring Road (MKAD), as well as an increase in the activity of developers.

Geographical distribution of existing warehouse space by highway, class A and B, '000 sq. m



DEMAND IS STABLE

Demand. Moscow region

1,229 '000 sq. m

Take up, class A and B

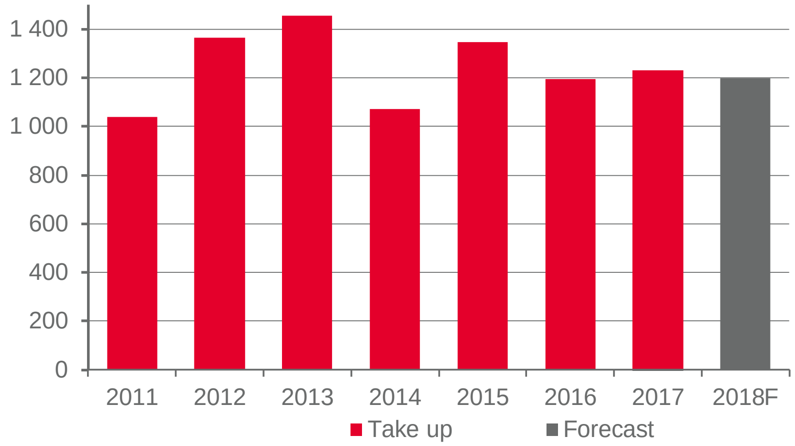
2017

1,200 '000 sq. m

Take up, class A and B

2018

Take up, classes A and B, '000 sq. m



Source: Cushman & Wakefield

In 2017, take up comprised 1.23 mn sq. m of quality warehouse space, which is close to the level of the same indicator in 2016.

The number of deals in 2017 decreased by 25% compared to 2016. In 2017, big-size warehouse units were in high demand. The average size of space requested for lease or purchase increased by 25%, to a total of 16,000 sq. m. However, there is a lack of existing large warehouse space, so consumers had to chose built-to-suit schemes. This was one of the reasons behind the slow decrease of the vacancy rate in the Moscow region.

In 2018, we expect the demand for warehouse space to remain at the level of 2016-2017 – take up will reach 1.2 mn sq. m.

RETAILERS ARE THE MAJOR TENANTS

Demand. Moscow region

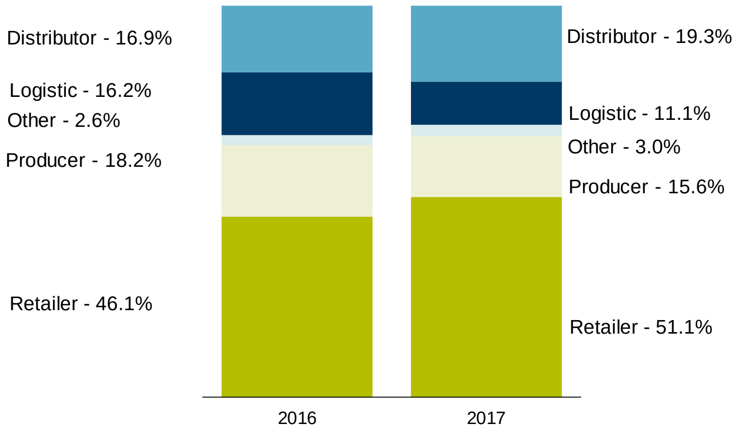
51 %

Share of retail in take up structure in 2017

30 %

Share of fashion retail in take up structure in 2017

Take up structure, 2017



Source: Cushman & Wakefield

Retailers have always had the largest share in take up structure. In 2017, this share reached 51%. Traditionally, retailers occupy big-size warehouse units. The average deal size for retail chains was 30,000 sq. m which is 47% higher than the market average. The share of fashion retailers increased from 5% in 2016 to 30% in 2017, the share of the food sector decreased from 27% in 2016 to 12% in 2017.

At the end of 2016, we noticed a trend of growing demand for warehouse space from manufacturing and logistics companies. The trend did not however, continue in 2017. After the growth of the manufacturing share in 2016 up to 18% and up to 16% in logistics, in 2017 the share of both segments decreased to the levels of 2015.

Warehouse & Industrial

REGIONS OF RUSSIA

The demand for warehouse space remains high. Developers prefer built-to-suit projects rather than speculative construction.

NEW CONSTRUCTION KEEPS DECREASING

Supply. Regions

377 '000 sq. m

New construction, 2017

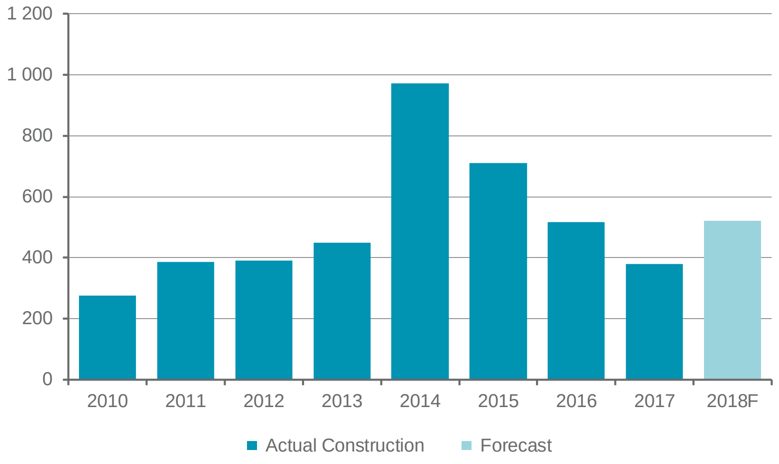
Class A and B

525 '000 sq. m

New construction, forecast, 2018

Class A and B

New construction, classes A and B, 2017



Source: Cushman & Wakefield

377,000 sq. m of quality warehouse space was delivered to the market in the regions in 2017, which is 195,000 sq. m less than in 2016.

48% of new space was constructed in Novosibirskaya, Samarskaya Oblast and Primorskiy Kray. The construction activity in these regions was higher than in St. Petersburg, the region with the second-highest reported amount of new construction, second only to Moscow. Construction activity in St. Petersburg reached its lowest level in the last 6 years. Low construction volume lead to warehouse space deficit and an increase in rental rates in the region.

We expect new construction in 2018 to be 30% higher than in 2017 – 525,000 sq. m of space will be delivered to the market. Preliminary lease and sale agreements are already signed for 57% of this space.

DEMAND INCREASE IN 2017

Demand. Regions

626 ‘000 sq. m

Take up, class A and B

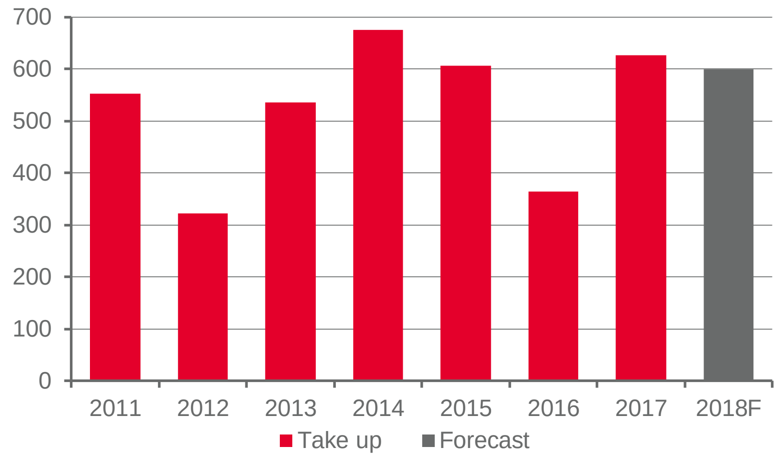
2017

600 ‘000 sq. m

Take up, class A and B

Forecast for 2018

Take up, classes A and B, ‘000 sq. m



Source: Cushman & Wakefield

All the indicators of 2017 in the regions were better than in 2016. Take up increased by 72% and comprised 626,000 sq. m. The number of deals grew by 60%. Average deal size reached 9,000 sq. m which is 14% higher than the same indicator in 2016. Thus, the two-year trend of take-up decrease has stopped.

Traditionally, the majority of transactions are executed in St. Petersburg. In 2017, 30% of deals were closed in this region, the next region by level of take-up was Ekaterinburg – 24% of regional transactions in 2017.

In 2018, we expect the demand for warehouse space maintain the level observed in 2017 – we predict that take up will comprise approximately 600,000 sq. m.

THE HIGHEST DEMAND IS FROM RETAILERS

Demand. Regions

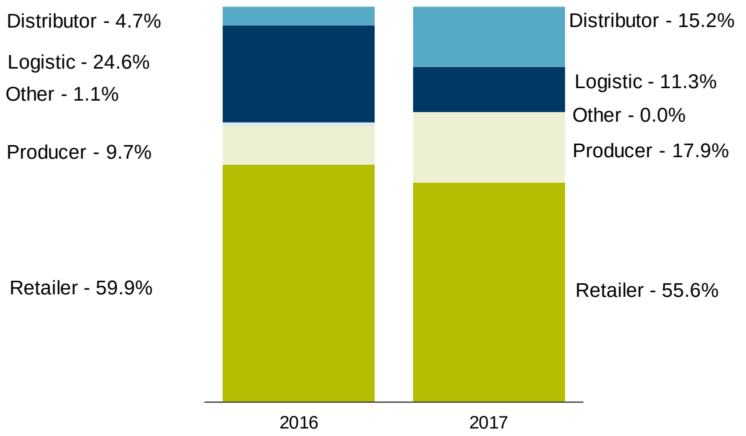
56 %

Share of retailers in take up structure in 2017

30 %

Share of food companies in take up in 2017

Take up structure, 2017



Source: Cushman & Wakefield

In the regions, we see a stable trend - more than 50% of warehouse space is leased or purchased by retailers. Around 30% of warehouse space is used for food storage.

The share of other segments varies from year to year and there are no clear trends.

We expect the trends to remain the same in 2018. The demand from retailers and food companies will remain at the same level.

LARGEST DEALS AND PROPERTIES COMPLETED IN 2017

Supply and demand. Moscow and regions

Key warehouse properties delivered to the market in 2016

Property	Highway	Region	Distance from city, km	Total area, 000 sq. m	Delivery
Orientir-Sever-2	Leningradskoe	Moscow	40	81.2	Q1, 4
PNK Park-Valischevo	Simferopolskoe	Moscow	39	50.1	Q4
FM Logistic Elektrougli	Gorkovskoe	Moscow	29	50	Q1
Technopark Uspenskiy	Gorkovskoe	Moscow	44	48.2	Q4
Dmitrov LP	Dmitrovskoe	Moscow	30	26,6	Q3
SK Oktavian	Toksovskoe	St. Petersburg	18	18.1	Q1
A Plus Park Perm	Krasnokamskaya	Perm	19	26.4	Q2
Aviapolis Yankovskiy	Vladivostok-Port Vostochniy	Vladivostok	48	46.8	Q1, 3
Sibirskiy	Omsky Trakt	Novosibirsk	2	71.5	Q4
Samaratransavto	Utevskaya	Samara	0	65	Q3, 4

Key warehouse deals in 2017

Tenant / Buyer	Property	Region	Deal type	Total area, ‘000 sq. m
Wildberries	Industrial Park Koledino	Moscow	BTS	146
Utkonos	Orientir Sever	Moscow	sale	68.7
Detskiy Mir	TLK Yuzhnouralskiy	Chelyabinsk	lease	46.1
X5 Retail group	Orientir Sever-2	Moscow	lease	45.1
KSS	Freight Village Vorsino	Kaluga	sale	36.6
Auchan	Samartransavto	Samara	lease	35.3
Monetka	A Plus Ekaterinburg	Ekaterinburg	BTS	34
Auchan	PNK Park Kosulino	Ekaterinburg	lease	30.4
Makita	Warehouse complex Pushkino	Moscow	lease	26.5
Krasnoe&Beloe	Rolsi	Ekaterinburg	lease	24.6

Section 2

HOSPITALITY

- Stabilization as the main theme of 2017 – with record occupancy levels (at 72.8%) at the cost of minor ADR adjustments (-2.1% in RUB).
- Substantial increase in supply (9.4% year-on-year), with the opening of 6 new properties for a total of 1,661 keys.
- Factors preventing active ADR growth – rate-sensitive demand (on top of supply increase) and currency strengthening (12.2% in USD).

>60 `000 keys

Overall estimated room stock

City of Moscow estimates, 2017

19.3 '000 keys

Modern quality room stock

Cushman & Wakefield's estimates, 2017

1,661 keys

In 6 new hotels

Net room stock increase over 2017

541 keys

In 2 new hotels

Net room stock increase in Q2, 2017

HIGH CONSTRUCTION ACTIVITY

Main supply increase – in Midscale and Economy segments

1,661 keys

New supply in 2017

6 new hotels

80 %

Bulk of added stock

Midscale and Economy segments

Source: Cushman & Wakefield

New supply in 2017

PROJECT	KEY COUNT	OPENING
Hilton Garden Inn Moscow Krasnoselskaya	292	Q1
Ibis Oktyabrskoye Pole	240	Q2
Ibis Budget Oktyabrskoe Pole (Panfilovskaya)	114	Q2
Azimut Moscow Smolenskaya Hotel (former Belgrad)	474	Q2-Q3
Holiday Inn Express Paveletskaya	243	Q4
Hyatt Regency Moscow Petrovsky park	298	Q4
TOTAL	1 661	

5 out of 6 new hotels (collectively – over 80% of new hotel stock) are in Midscale- or Economy-grade properties. The only high-grade hotel opened in 2017 is the Hyatt Regency Moscow Petrovsky Park (Upper-Upscale).

RECORD GROWTH OF HOTEL SUPPLY

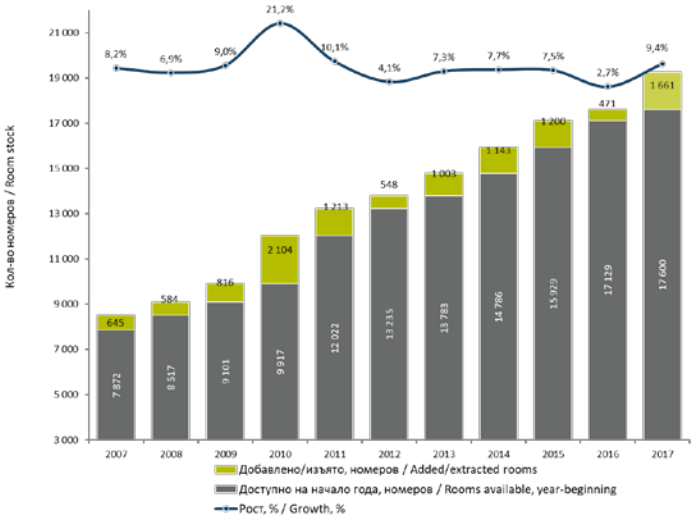
Main reason – delayed completions

9.4 %

Year-on-year growth

Exceeds 10-year average rate of 8.5%

10-year supply growth dynamics



Source: Cushman & Wakefield

In 2017, modern quality stock grew by 9.4%, the highest increase in 6 years and more than the weighted average growth rate of 8.5% registered between 2007-2016.

The main reason for such a hike, in Cushman & Wakefield's view, are the delayed completions of projects started before or in the early phases of the 2014-2015 crisis. A similar peak in new openings (21.2% and 10.1%) was observed in 2010 and 2011, respectively, as the market was bottoming out from the previous crisis in 2008-2009.

SUPPLY AND DEMAND ATTEMPT TO FIND BALANCE

Record occupancy levels at the cost of accommodation rates

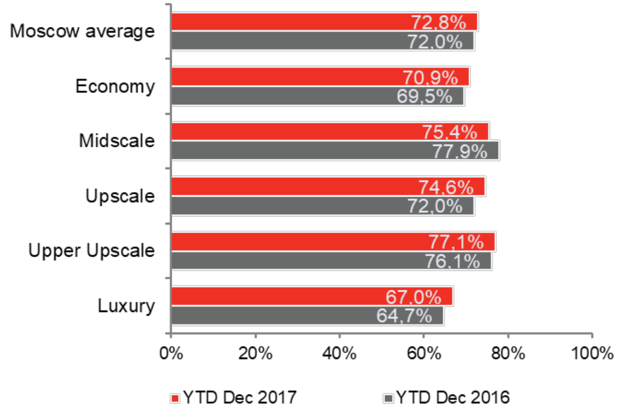
72.8% YTD Dec 2017

Wider market

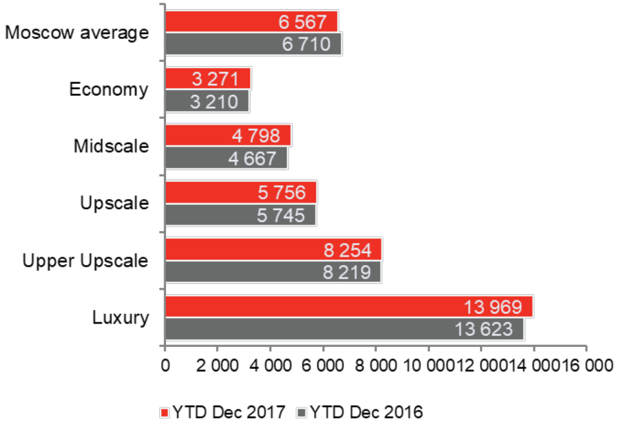
-2.1% Year-on-year ADR change (in RUB), YTD Dec 2017

Wider market

Occ, YTD Dec 2017, by segment



ADR (in RUB), YTD Dec 2017, by segment



In 2017, the average annual occupancy rate for the modern quality stock (Wider market) reached 72.8% (+0.8 ppt vs. 2016), the highest recorded occupancy level in 12 years of observations.

The substantial increase of lower-grade hotel rooms coupled with a ramp-up trading period (when new hotels start selling their rooms at a discount to other operating properties) kept pressure on ADR levels for the Wider market which dropped 2.1% year-on-year (from RUB 6,710 in 2016 to RUB 6,567 in 2017). At the same time, each individual price segment demonstrated small improvements in their ADR levels relative to 2016.

Source: Cushman & Wakefield

REVPAR – NO BIG CHANGES STILL

-1.0 %

YTD Dec 2017 RevPAR change (in RUB)

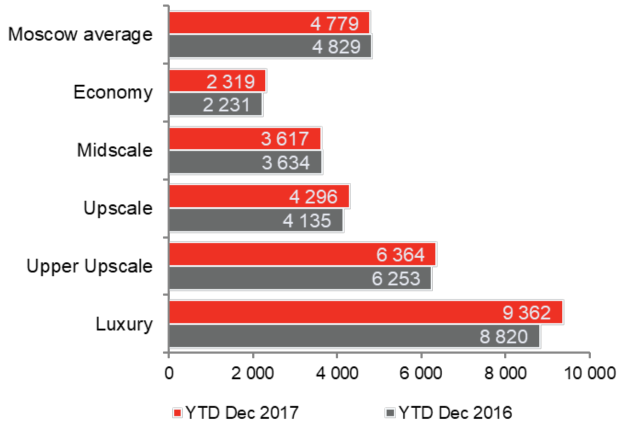
Wider market

6.1 %

Highest RevPAR growth in 2017 (in RUB)

Luxury segment

RevPAR (in RUB), YTD Dec 2017, by segment



Source: Cushman & Wakefield

While the average annual RevPAR indicator in 2017 reached RUB 4,779, which translated into a 1% drop year-to-year, some price segments reported more positive results.

The best performing hotels were found in the Luxury segment (6.5% growth year-to-year) as well as in the Upscale and Economy segments (3.9% in each). Hotels in the Upper-Upscale comp set added 1.8% to the previous year's ADR, while the Midscale segment which had the largest influx of new rooms (766 keys) ended up with negative ADR dynamics (-0.5% year-to-year).

Overall, however, the RevPAR indicator managed to avoid large fluctuations, which turned out to be good news for a market faced with substantial growth in supply.

SITUATION CORRECTED IN H2 2017

Starting in June, the RevPAR indicator was outpacing monthly results of 2016 and 2013

RevPAR dynamics (in RUB), by month

H1 was a low point for many hoteliers, due to several negative factors. Aside from growing supply, the market struggled due to cold weather at the beginning of the summer season, the re-opening of the Turkish market for holiday-makers and the MICE business, appreciation of the rouble, recurring problems with national air carriers, etc. Still, the hard work of sales & marketing professionals in the hospitality industry contributed to the reversal of the RevPAR trend at the start of the summer season – as is shown on the graph.

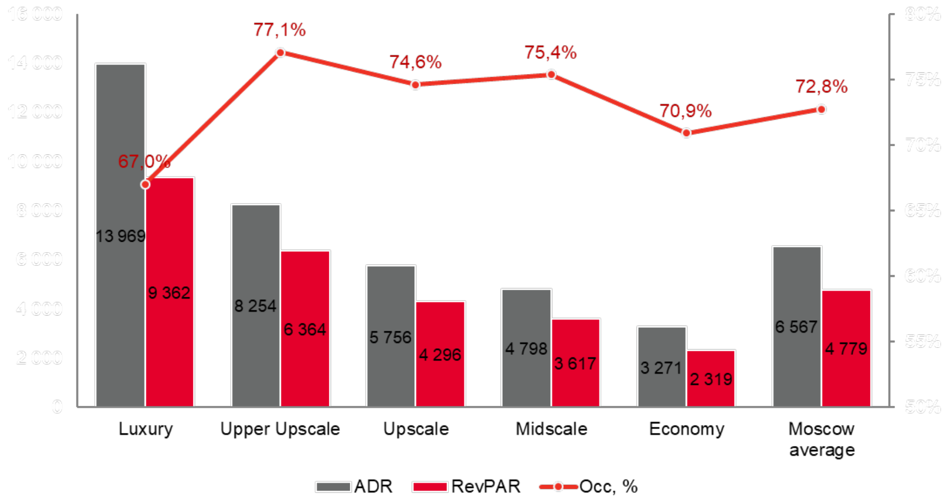
As a result, starting from June, the monthly RevPAR indicator of the Moscow hotels was consistently outpacing the room yield for similar periods of 2016 as well as of the ‘benchmark’ year of 2013.

#MARKETBEAT

2017 AS DRESS REHEARSAL FOR THE 2018 WORLD CUP

The modern quality hotel market appears to be well prepared for the main event of the year.

2017 operating results, by segment



In general, the Moscow hotel market ended 2017 with positive results – with occupancy levels exceeding the 70% mark in nearly all price segments, and even marginal (between 0.2% and 2.5%, depending on the segment) ADR growth observed. With inflation of the rouble under control, this can be viewed as a very reasonable outcome.

2018 should serve as the litmus test of the Moscow market's readiness for a radical increase in the number of visitors (the World Cup event is generally expected to attract at least 700,000 more visitors than would otherwise be reported in a typical year), and of the local hoteliers' ability to accommodate and service substantially higher levels of hotel guests in the short- to mid-term perspective.

#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 deposit withdrawal as penalty. After crisis became very popular. Notice period is 6-12 months. When there is an option to review the rent after the third year, 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: 1-3 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: 5-10% 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% (fashion), 1-3% for large 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 included to 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.

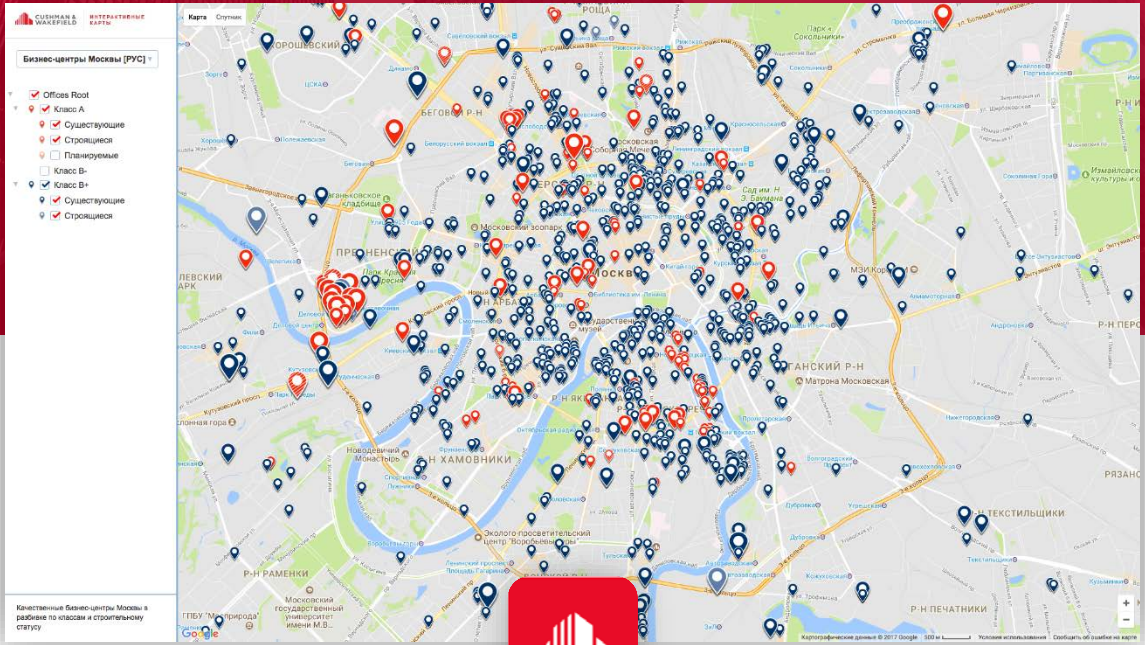
TAXATION

REAL ESTATE TAX
Landlord: the amount of tax depends on the region. In Moscow for office and retail: 1,4% in 2017, 1,5% in 2018 of cadastral value (1.2% of in 2015, 1.3% in 2016).
Tenant: can be partly or fully included to service charges paid by tenant.

VAT: 18%

Cushman & Wakefield в России

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

Denis Sokolov
Partner,
Head of Research
Denis.Sokolov@cushwake.com

Tatyana Divina
Associate Director,
Deputy Head of Research
Tatyana.Divina@cushwake.com

Marina Smirnova
Partner,
Head of Hospitality and Tourism
Marina.Smirnova@cushwake.com

Alexander Kuntsevich
Senior Analyst
W&I Research
Alexaner.Kuntsevich@cushwake.com

Maria Logutenko
Junior Analyst
Office Research
Maria.Logutenko@cushwake.com

Evgeniya Safonova
Analyst
Retail Research
Evgenia.Safonova@cushwake.com

For more information and contacts please visit www.cwrussia.ru

About the company

CUSHMAN & WAKEFIELD IN RUSSIA

Cushman & Wakefield is a global leader in commercial real estate services, helping clients transform the way people work, shop, and live. The firm's 43,000 employees in more than 60 countries provide deep local and global insights that create significant value for occupiers and investors around the world. Cushman & Wakefield is among the largest commercial real estate services firms with revenues of $5 billion across core services of agency leasing, asset services, capital markets, facility services (branded C&W Services), global occupier services, investment management (branded DTZ Investors), project & development services, tenant representation and valuation & advisory.

Key contacts

CUSHMAN & WAKEFIELD IN RUSSIA

MANAGEMENT

Sergey Riabokobylko
Executive Partner, CEO
M +7 985 764 6436
sergey.riabokobylko@cushwake.com

Mikhail Mindlin
International Partner, COO
M +7 985 763 5803
mikhail.mindlin@cushwake.com

Pavel Ivashin
Partner, CFO
M +7 985 924 1671
pavel.ivashin@cushwake.com

AGENCY

Pavel Baranov
Partner, Head of Occupier Services
M +7 985 364 6253
pavel.baranov@cushwake.com

Evgeny Popov
Partner, Strategy & Transaction collaboration
M +7 916 590 6805
evgeny.popov@cushwake.com

Diana Mirzoyan
Partner, Land
M +7 985 764 7314
diana.mirzoyan@cushwake.com

Egor Dorofeev
Partner, Head of Warehouse & Industrial
M +7 985 923 6563
egor.dorofeev@cushwake.com

Evgeniya Osipova
Head of Retail
M +7 919 105 7905
evgeniya.osipova@cushwake.com

Andrey Shuvalov
Associate, Retail
M +7 903 256 2174
andrey.shuvalov@cushwake.com

Dmitry Tarasov
Head of Office Agency
M +7 926 833 66 93
dmitry.tarasov@cushwake.com

Ilya Kouznetsov
Head of Russian Regions: Corporate Services
M +7 916 501 4217
ilya.kouznetsov@cushwake.com

CONSULTING

Marina Smirnova
Partner, Head of Hospitality & Tourism
M +7 985 410 7237
marina.smirnova@cushwake.com

Marina Usenko
Partner, Hospitality & Tourism
M +7 916 173 6656
marina.usenko@cushwake.com

Julia Tokareva
Partner, Head of Development Consultancy
M +7 985 222 7247
julia.tokareva@cushwake.com

Konstantin Lebedev
Partner, Head of Valuation & Advisory
M +7 985 784 4705
konstantin.lebedev@cushwake.com

Oleg Takoev
Partner, Valuation & Advisory
M +7 910 463 4278
oleg.takoev@cushwake.com

Denis Sokolov
Partner, Head of Research
M +7 916 901 0377
denis.sokolov@cushwake.com

PROJECT MANAGEMENT

Semyon Yurchenko
Partner, Head of Asset Services
M +7 919 967 2568
semyon.yurchenko@cushwake.com

Andrey Chertischev
Partner, Head of Project Management
M +7 916 557 2838
andrey.chertischev@cushwake.com

CAPITAL MARKETS

Andrey Bezverkhiy
Associate, Capital Markets

M +7 910 440 1413
andrey.bezverkhiy@cushwake.com