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Commercial Real Estate - Russia

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Cushman & Wakefield Research Department

Apr '18

Macroreview

Capital Markets

Offices

Retail

Warehouse & Industrial

Hospitality & Tourism

Q1 | 2018

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Outlook

VOLATILE STABILITY

Political shocks during the month of April pushed the market out of equilibrium. Meanwhile, the conversation has shifted away from its prior vagueness and abstraction as the factors driving economic development have now become more evident. A further observed problem is that, instead of the expected stability, the market has experienced predicted volatility.

Outlook

SUMMARY

The second quarter will be characterized by greater volatility. The upcoming World Cup has the potential to positively influence the attitudes of market players.

The start of the second quarter has not brought the long-expected stability. Contributing to this volatility is speculation regarding the composition of the new Cabinet of Ministers, which will take place following the presidential inauguration on the 7th of May, as well as ongoing attention stemming from the poisoning of Sergei Skripal in Salisbury, England and the resulting international diplomatic scandal. And finally, the latest round of sanctions has further contributed to the observed volatility. This volatility has resulted not from the new sanctions, as they were largely expected, but rather from the reaction of the stock and exchange markets as well as the government.

Even though the escalation was expected, based on the popular reaction to the latest round of sanctions, April has become something of a turning point, such that now even the most optimistic of market players understand that sanctions, and the depressed economic growth that follows, are both an inevitable part of the future.

We do not expect positive economic news in the second quarter. The value of the ruble will likely stabilize at an exchange rate of 60 rubles to 1 US dollar, and the Central Bank will hold back on decreasing the key interest rate. The market will begin to grow more rapidly, and tenants and landlords will reluctantly enter into long-term agreements.

However, this sort of volatility provides an opportunity to those investors interested in acquiring new assets.

Given that the real estate sector has already weathered a prolonged series of negative developments, particularly as it concerns price levels, we predict that the latest round of sanctions will not have a substantial effect on commercial real estate prices.

However, any sort of improvement in the current economic climate will encourage future economic growth.

In the second quarter the market will be disorganized. We expect more positive developments no earlier than in Q3.

The World Cup, along with the Moscow Urban Forum, could provide a favorable backdrop for the real estate market in the second half of the year.

Section 1

MACROREVIEW

- Macroeconomic forecasts will likely worsen, though not significantly.
- The formation of the Cabinet of Ministers, to take place in May, will most likely be merely cosmetic in nature.

MACRO INDICATORS

	2017	2018	2019	2020	2021
GDP growth, %	**1,6**	**1,8**	**1,4**	**1,2**	**1,2**
RUB/USD	58,3	55,9	56,1	56,6	57,1
CPI, %	3,7	3,2	4,0	4,0	4,0
Interest rate	10,61	8,9	8,63	8,4	8,22
Current Balance, % of GDP	1,5	2,2	1,6	0,8	0,2
Private consumption, %	4,4	3,0	2,8	2,3	2,0
Government spending	0,5	0,3	0,6	0,7	0,8
Capital outflow, bn USD	4,05	83,4	73,4	70,0	75,7
Unemployment rate, %	5,21	5,14	5,21	5,14	5,09
BRENT crude oil price	54,2	66,8	65,3	65,5	67,8

Source: Oxford Economics 13/03/2018

ECONOMIC INDICATORS ARE IN THE “GREEN ZONE”

The results of Q1 confirm our predictions regarding consumer demand. However, despite modest growth in household income as well as retail turnover, the contribution of the consumer sector to GDP growth in Q1 was more significant, than any of the other sectors.

1.8 %

GDP Growth forecast for 2018

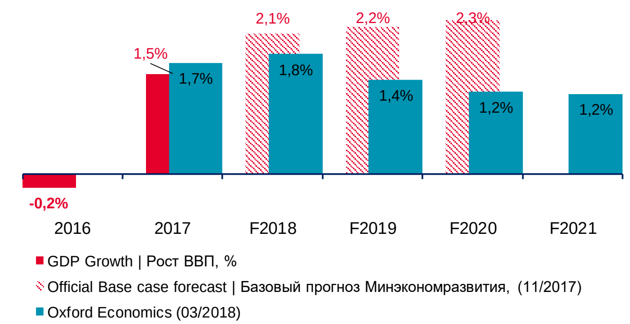
Oxford Economics

2.2 %

Inflation

February 2018 to February 2017, Rosstat

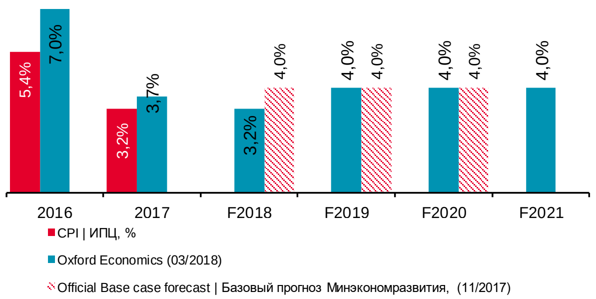
GDP Growth, %



Despite a slow start in Q1 and a new round of sanctions, economic development forecasts in Russia remain positive.

Oxford Economics predicts GDP growth of 1.8% in the upcoming year. The official forecast of the Ministry of Economic Development has not been updated since November of 2017, however we believe that in Q2 the official forecast will be revised. In sum, we predict that that the growth rate will increase in Q2 and furthermore that the main economic indicators will begin to reflect a more positive economic situation

The Consumer Price Index, %



Low inflation continues to represent a critical factor in the health of the Russian economy. Immediately following the annual calculation in February, inflation stood at 2.2%, the lowest rate in contemporary Russian history. It is expected that in Q2, Q3, and Q4 inflation will increase slightly. This historically low rate suggests a persistence of the preference of savings and austerity.

However, further escalation of tensions and imposition of trade restrictions with the United States could lead to an increase in inflation in the middle of the year.

Outlook

THE CONSUMER MARKET IS NOT PERFORMING AS PREDICTED

Despite the recovery of the consumption sector, it is not currently in a sufficiently strong position so as to drive the Russian economy forward. The return of a consumption-driven behavior model has not accordingly lead to a multiplier effect. Mortgage lending and the housing market remain the main drivers of growth.

HOUSEHOLD DEBT

Toward the end of 2017 Russian households shifted away from a behavior model characterized by a preference for savings to one that was instead characterized by a preference for spending. However, as was the case previously, the growth of the lending market can largely be attributed to the growth of mortgage loans.

220 ‘000 RUB

Average Debt of Russian Households

01/03/2018

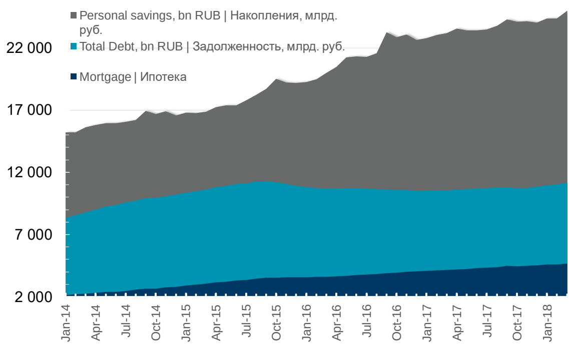
1.7 %

Growth of Mortgage Debt

February 2018

Source: Central Bark, C&W calculations

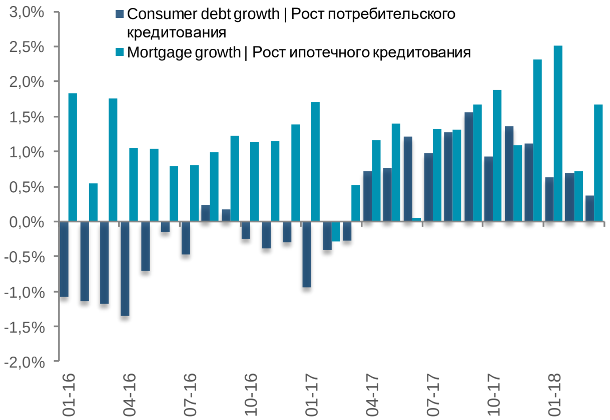
Shares and deposits (of physical persons), bn RUB



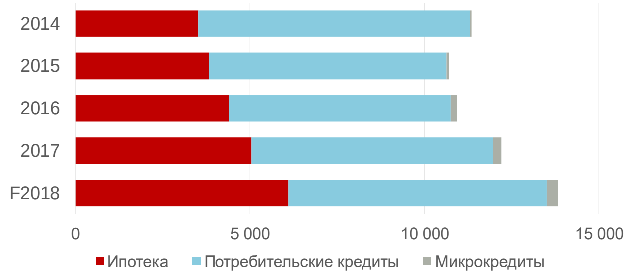
In 2017 household debt grew by 12%, while mortgage debt grew by 15%. Microcredit loans grew by 30%, however the share of said loans as a portion of household debt does not exceed 2%.

At he beginning of 2018 the high rate of growth of the share of mortgage debt persisted, and in February mortgage debt increased by 1.7%.

Growth Rate of Household Debt



Household debt structure, bn RUB



Fundamentals

CORPORATE DEBT

The 0.5 percentage point decrease in the key interest rate in March, as well as the expected future decrease in the key rate later on in 2018 have both contributed to positive economic forecasts. However, the recent Central Bank announcement regarding volatility in the exchange rate could lead to greater lending within the Russian economy.

7.25 %

Key Rate

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

25.5 %

Overdue Debt

In Real Estate sector

Power BI

Source: The Central Bank of Russia

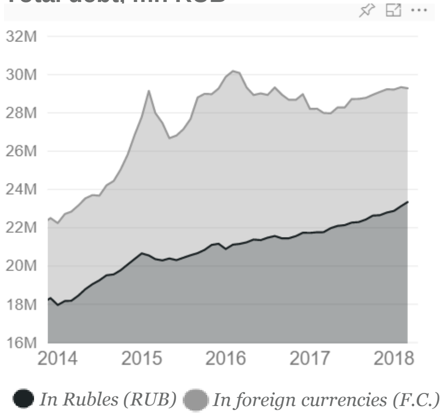
Lending recovered during in H2 2017. However, at the start of 2018 the credit expansion rate decreased. Within the retail market, lending has been frozen since 2017. Potential limits on the import of consumer products from the United States could further contribute to the depression of retail markets.

Overdue debt has become a serious threat to the different sectors of the real estate market.

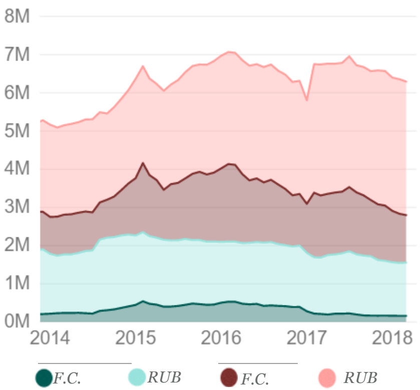
The share of overdue debt within the construction and real estate and retail operational sectors as of March 2018 was 19.5%, 25.5%, and 12.5% respectively. The average economic indicator, again as of March 2018, was 7%.

Corporate debt and overdue debt

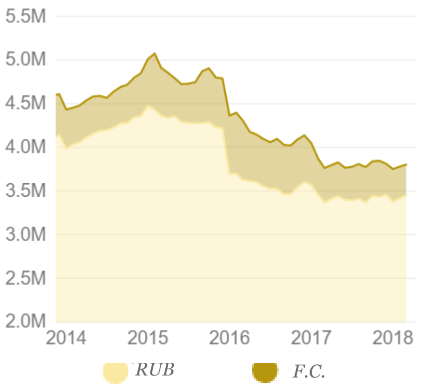
Total debt, mn RUB



Construction and real estate, mn RUB



Overdue debt



#MARKETBEAT

PUBLIC RETAIL AND DEVELOPMENT COMPANIES

Stock Market Indicators from 17/01/18 to 16/04/2018 as compared to the MICEX index

+12.3 %

Sistema Hals

The growth leader over the past 90 days

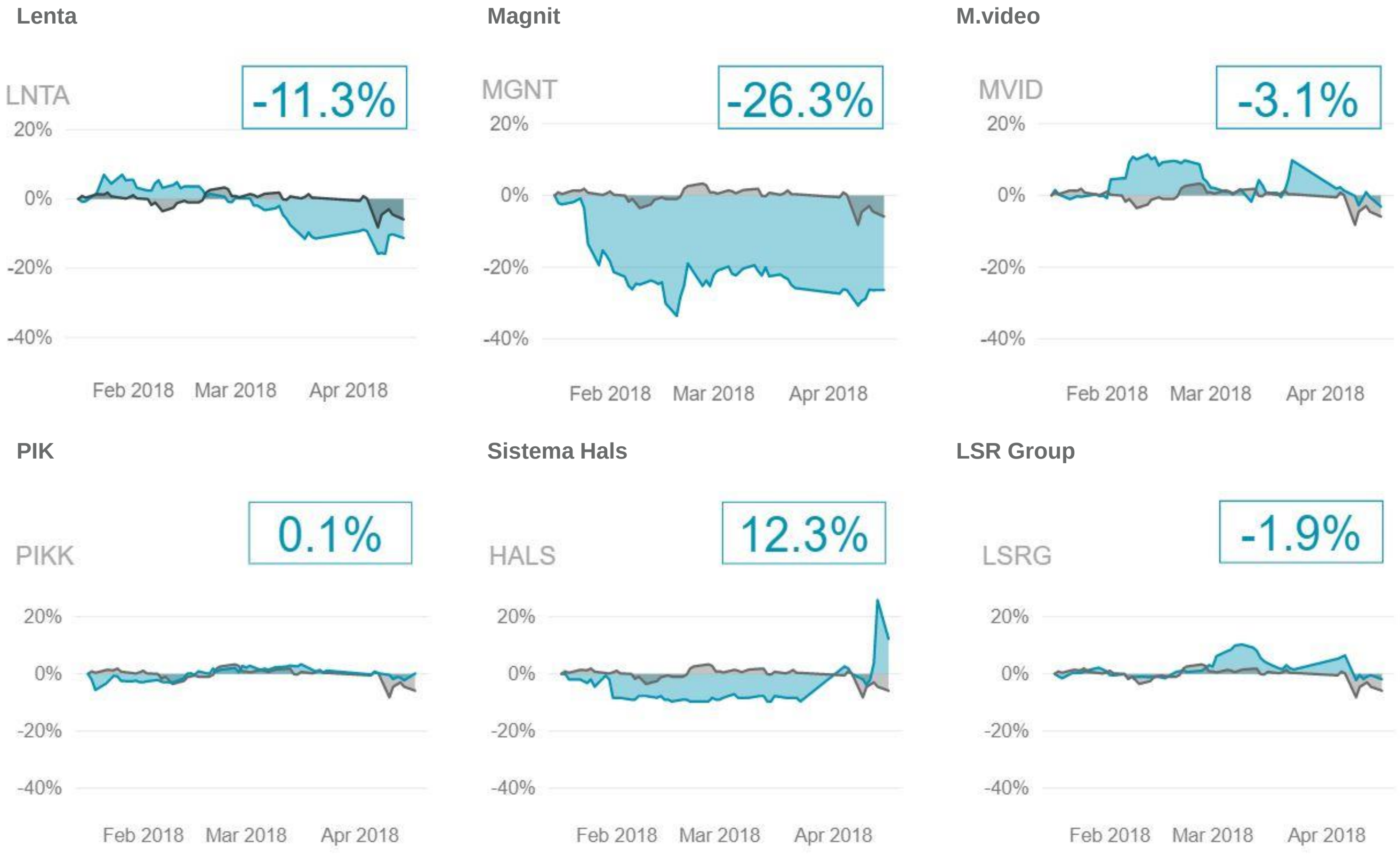
-26.3 %

Magnit

The largest fall for the period of 90 days

Power BI

Source: MICEX, Yahoo Finance



Section 2

CAPITAL MARKETS

- A slow start in 2018.
- The decline in the capitalization rate will slow due to the weakening of the ruble.
- In 2018 we expect to see a series of large transactions.

170 mn EUR

Total investment volume in Russia

In Q1 2017

4.5 bn EUR

Total investment volume in Russia

Forecast for 2018

9.5 %

Capitalization rate, prime office segment

Q1 2018

+27 %

Investment volume growth

In 2017

Capital Markets

THE CAPITALIZATION RATE DECREASED BY 0.5 PERCENTAGE POINTS

The main risks for real estate today are concentrated in the exchange zone, as in 2018 there will be ongoing volatility in the value of the ruble

EASTERN EUROPEAN INVESTMENT IN COMMERCIAL REAL ESTATE

Poland retains its position as having the strongest investment market in the region. In Q1 2018, Poland's share of total recorded investment accounted for 80% of all investments in commercial real estate across Eastern Europe.

3.1 bn EUR

Investments in Central and Eastern Europe

Commercial real estate, Q1 2018

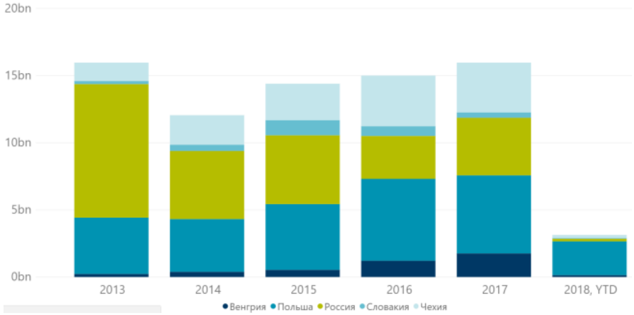
2.5 bn EUR

Investment volume in Poland

The largest investment market in CEE region in Q1 2018

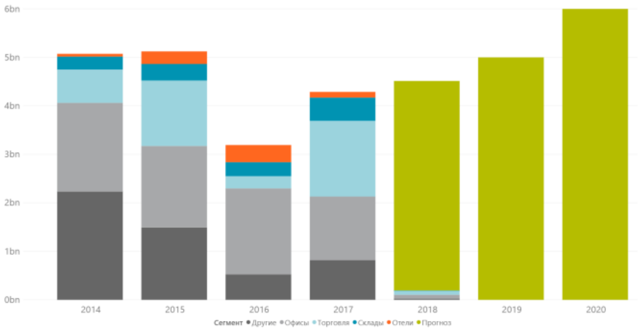
Source: Real Capital Analytics

Investments on the core CEE markets, bn EUR



Thus far in 2018 the investment market in Eastern Europe has reported disappointingly low volumes. Total investment in commercial real estate in the region as of the end of Q1 2018 was approximately three billion euros. Of this total volume, 2.5 billion can be attributed to Poland, which retained its position as the country with the largest investment market in the region. Total investment in the Q1 was less than 20% of planned investment for the entirety of 2018.

Investments in Russia, bn EUR



The Russian investment market has experienced a slow start to the year. Investment for 2018 is expected to total 4.5 billion euros, however investment in the Q1 totaled a mere 170 million.

However, we do not expect to revise our 2018 investment forecast given that our predicted series of large transactions will be reflected only in the returns of Q2. Thus, we predict that investment volumes will increase over the course of the year and potentially even exceed 4.5 billion euros by the year's end.

Capital Markets

CAPITALIZATION RATES

9.5 %

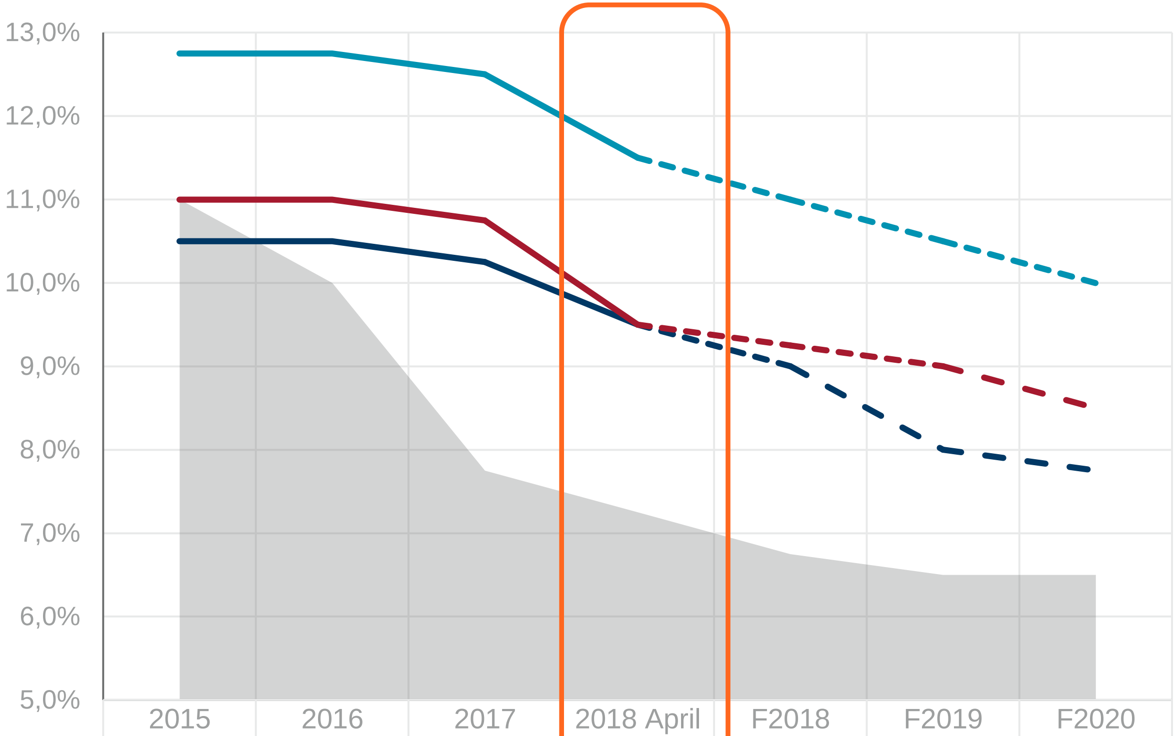
Office

Capitalization rate, Jan 2018

7.25 %

The key rate

The Central Bank of Russia



	2015	2016	2017	2018 April	F2018	F2019	F2020
Ключевая ставка ЦБ	11,00%	10,00%	7,75%	7,25%	6,75%	6,50%	6,50%
Офисы	10,50%	10,50%	10,25%	9,50%	9,00%	8,00%	7,75%
Торговые Центры	11,00%	11,00%	10,75%	9,50%	9,25%	9,00%	8,50%
Склады	12,75%	12,75%	12,50%	11,50%	11,00%	10,50%	10,00%

INVESTMENT STRUCTURE

Foreign investment continues to account for a relatively small share of the Russian market, a dynamic that is expected to continue in the upcoming years.

64 %

The share of foreign investments

The Central and Eastern Europe

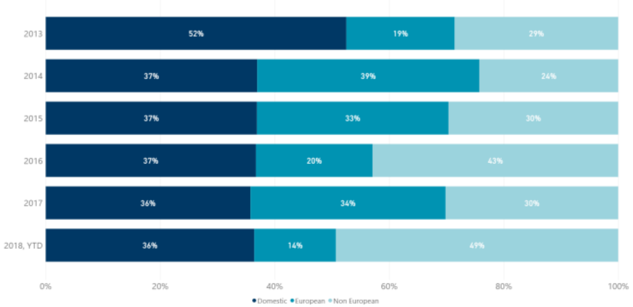
0 %

The share of foreign investments

Russia, Q1 2018

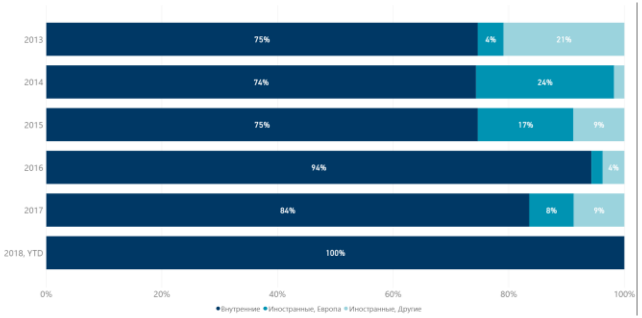
Source: Real Capital Analytics

The Central and Eastern Europe



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

Russia



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

We predict that the share of international investment in the Russian market in the upcoming years will not exceed 20%, so long as the market does not become more open to international capital.

Section 2

OFFICES

Since the end of 2017 there have been a positive dynamics in the office real estate market. Indicators show slight improvement though there are no preconditions for speculative growth.

The market reached equilibrium and this year it will most likely maintain that equilibrium. Nevertheless, the geopolitical situation remains the main risk factor.

Moscow Q1 2018

Classes A, B+ & B-

16.95 mn sq. m

Total stock of office buildings 13/04/2018

37 ‘000 sq. m

Construction

107 ‘000 sq. m

Net absorption

479 ‘000 sq. m

Take-up

Offices

THE YEAR OF THE REALIZATION OF OPPORTUNITY AT THE BEGINNING OF A NEW MARKET CYCLE.

It's time to start new projects and make decisions about relocations while there are many low-market opportunities that show signs of recovery.

Offices

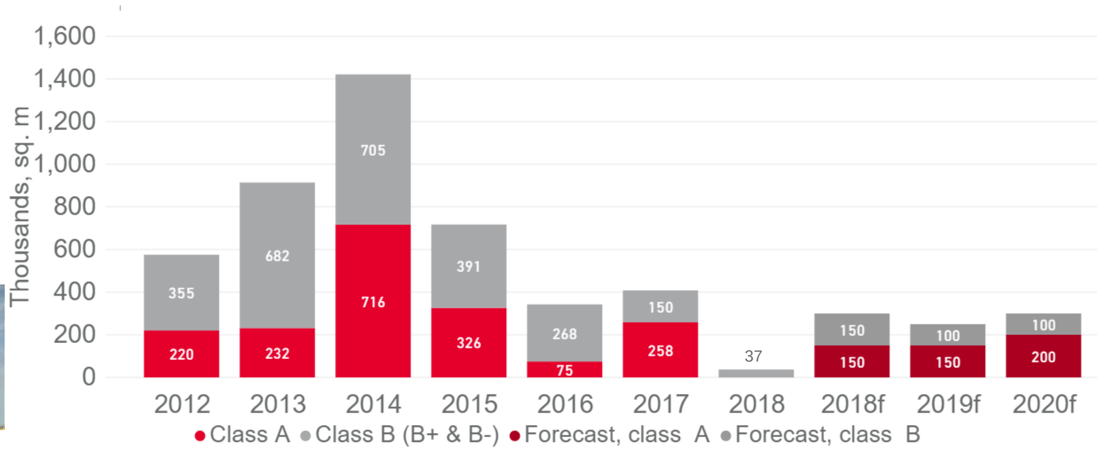
NEW SUPPLY

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

In Q1 2018 new construction amounted to 37,000 sq. m. Four small office buildings were delivered into the market, the largest of which was the La-5 with rentable area 16,800 sq. m.

Half of new construction volume in 2017 can be attributed to 2 towers in the City, in 2018 the delivery of such big buildings is not expected. Thus, the pace of construction in 2018 will be slightly lower than in the previous year. In 2018 - 2020 we expect lower levels of construction activity.

New construction, class A and B



DEMAND

Total take-up of Q1 is at the level of comparable periods in "pre-crisis" years and demonstrates a consistent increase of business activity.

479

‘000 sq. m

Take-up (lease and sale deals)

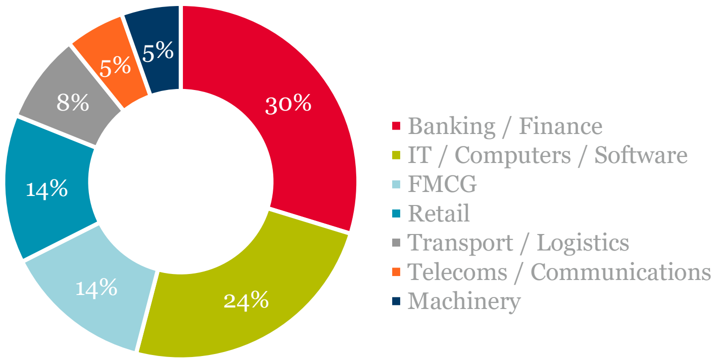
Q1 2018

Source: Cushman & Wakefield

In 2017, large deals (> 5,000 sq. m) accounted for 15% of total take-up, but in Q1 2018 demand structure changed. Deals with big office blocks accounted for only 3%, the largest of which was the X5 Retail Group deal in BC Oasis (9 701 sq. m).

The most active industries in Q1 were Banks and Finance (30%), IT and Computers (24%), and FMCG and Retail (14%).

The most active industries by closed deals in Q1 2018



In 2017 demand was at a record high, accordingly this year it will adjust and return to the average level from the previous five years (~ 1.7 mn sq. m per year). Furthermore, an election year typically leads to a decline in business activity.

In recent years the demand for office space in class A has grown. From 2011-2014 average annual take-up in this class was 350,000 sq. m, and from 2014-2017 - about 550,000 sq. m. Tenants have taken advantage of more recent opportunities, associated with loyal rental conditions for the most high-quality premises. By the end of Q1 we expect the demand for high-quality offices to remain at the level from 2017.

ABSORPTION RETURNS TO THE POSITIVE ZONE

Following the results of Q1, absorption continued the trend from the end of the previous year and confidently reached the positive zone. Against background of low construction activity additional premises are taken off the market.

107

'000 sq. m

Absorption in Q1 2018

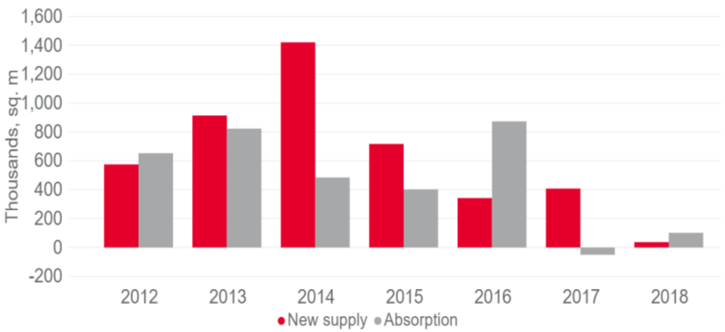
37

'000 sq. m

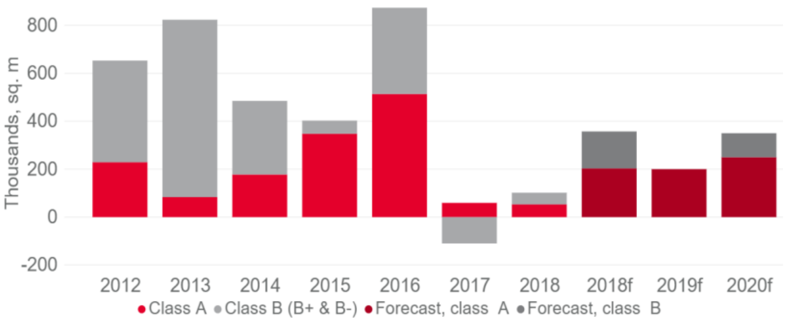
New construction in Q1 2018

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

The vacancy rate (in Classes A, B + and B-) decreased by 0.5 percentage points to 12% and will remain at this level throughout the year.

12.0 %

Vacancy rate in Q1 2018

Classes A and B (B+ & B-)

2 mn sq. m

Vacant premises in Q1 2018

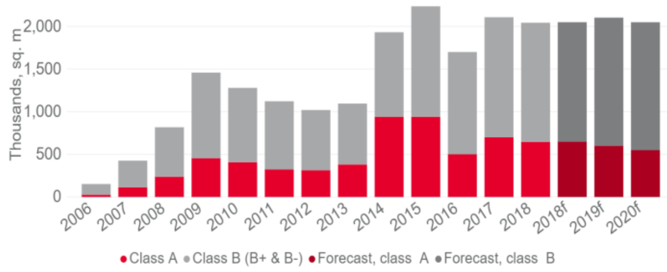
Classes A and B (B+ & B-)

Source: Cushman & Wakefield

Vacancy rates

Due to a consistently low rate of new construction and high take-up, the vacancy rate continued the decline, begun in the middle of last year, amounting to 12% at the end of Q1 2018. The decline in the vacancy rate is associated with a decrease in vacant premises in Class A. The indicator for class B remains stable.

Vacant premises



Against a background of positive absorption and low new construction, the vacancy rate in 2018-2020 will remain at a stable level of 12.0 - 12.5%.

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.

OFFICE PREMISES EXPOSITION

The share of vacant office premises in the market is no longer a significant factor. The issue is not how much vacant space there is in the market, but instead what is needed in order to turn over the premises within a year.

64%

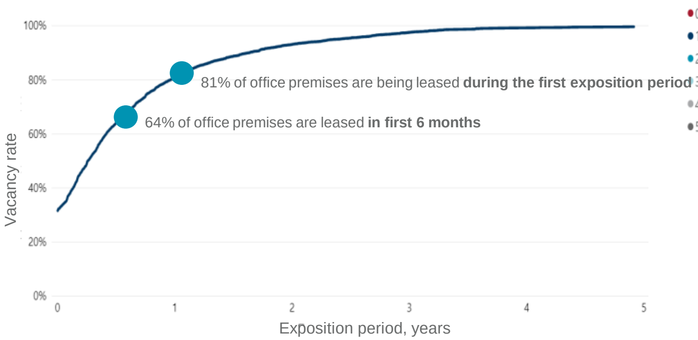
Of all office premises in Moscow are leased in first 6 months

81%

Of all office premises in Moscow are being leased during the first exposition period

Source: Cushman & Wakefield

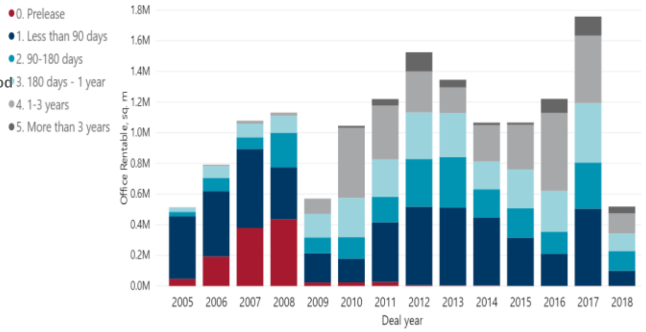
Office area by exposition period



The data accumulated over 13 years of observation makes it possible to state that the exposition of office premises follows a single pattern, one in which 80% of all offices are rented within one year.

The likelihood of leasing an office block is reduced by three every 6 months. The number of leased premises in the first 6 months increases every quarter due to active decision-making about relocations resulting from favorable market conditions.

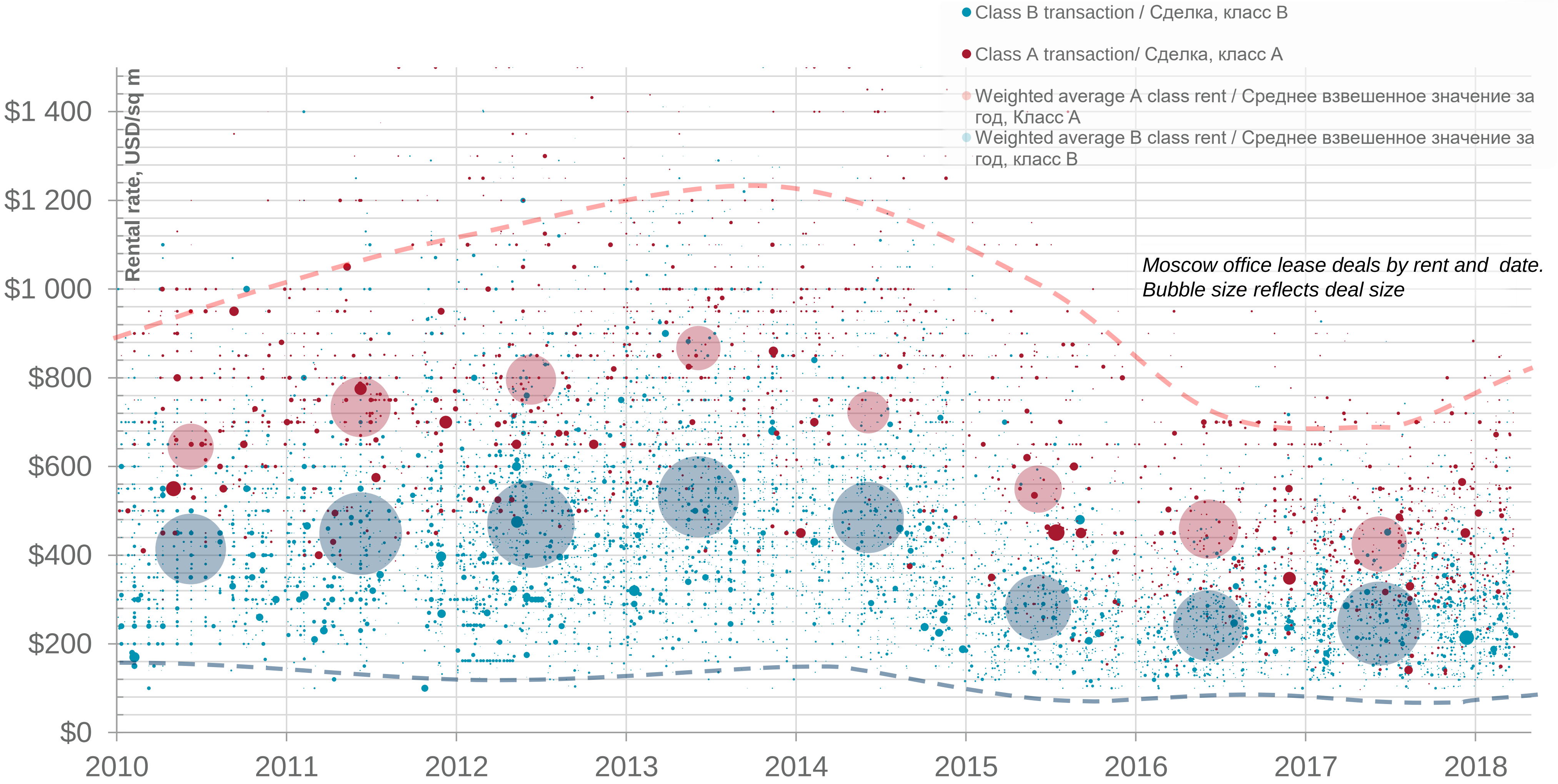
Deals structure in Moscow real estate market by exposition period



30% of all deals are for office premises on the market for less than 90 days or "out of market" premises. In 2016 a high share of deals with an exposition period of more than a year (~ 50%) can be explained by high turbulence and repricing of illiquid premises.

The reason for the absence of pre-lease deals is the presence of a sufficient amount of office space.

LEASE DEALS IN MOSCOW



Offices

RENTAL RATES

Forecast: A gradual increase in rental rates (at the index level).

315

USD / sq. m annum

April 2018

Dollar equivalent (all deals in classes A and B)

18,103

RUB / sq. m annum

April 2018

Ruble equivalent (all deals in classes A and B)

Source: Cushman & Wakefield

Rental rates in US dollars

The average dollar equivalent of rental rates in Class A for the first 4 months of 2018 is 457 USD/ sq. m/year.

The average ruble equivalent of rental rates is 15,194 Rubles/ sq. m/year.

The average rental rate in total (Classes A and B) exceeded the previous year's figure by 4%, but it is too early to project consistent growth.

Rental rates in Russian rubles

There are still not yet sufficient economic preconditions for speculative growth in rental rates, but despite the volatility of the economy as well as certain geopolitical factors, we predict further stability of rental rates.

RENTAL RATES

Since 2017 the share of lease deals conducted in USD remains at the 7% – 8% (following a 98% share in 2014 and significant decreases in the proceeding years), but due to the volatility of exchange rate we expect further decline in the share of lease deals, mostly due to the performance of class A; in class B the number of deals in foreign currency remains minimal (1.0 - 1.5%).

21%

Share of USD lease deals

Class A

6.7%

Share of USD lease deals

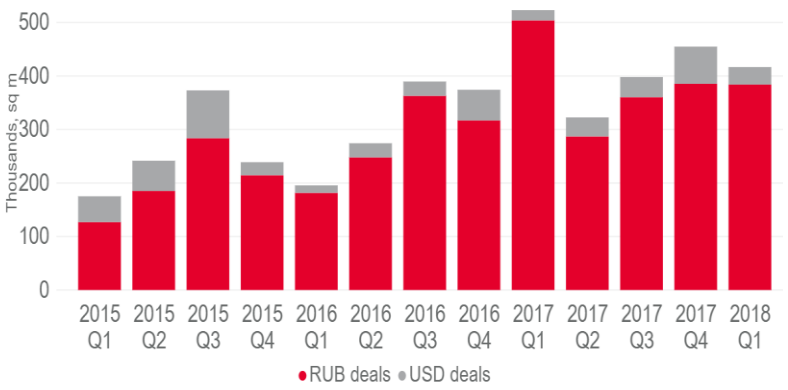
Classes A and B (B+ & B-)

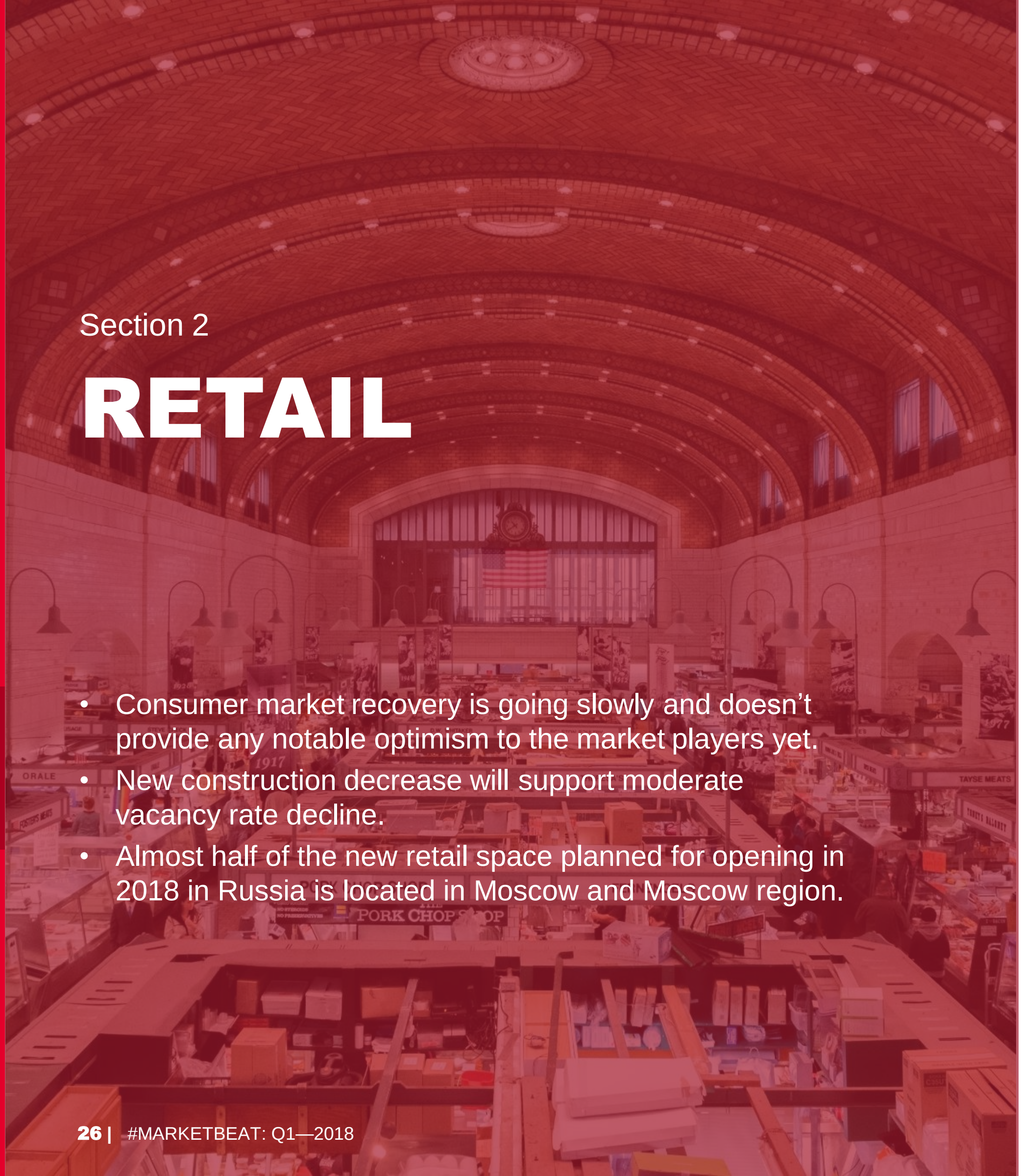
Source: Cushman & Wakefield

Leasing demand and rental rates

Class	Deal currency	Deals volume, sq. m	Rate
A	USD	28,170	$575
	RUB	98,225	25,001 rubles
B+ & B-	USD	3,993	$441
	RUB	303,362	14,462 rubles

Leasing demand and rental rates





Section 2

RETAIL

- Consumer market recovery is going slowly and doesn’t provide any notable optimism to the market players yet.
- New construction decrease will support moderate vacancy rate decline.
- Almost half of the new retail space planned for opening in 2018 in Russia is located in Moscow and Moscow region.

5.1 mn sq. m

Total quality stock in Moscow

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

19 ‘000 sq. m

New construction, Moscow, 2017

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

9.5 %

Vacancy rate

Quality shopping centers, Moscow

150 ‘000 RUB / sq. m

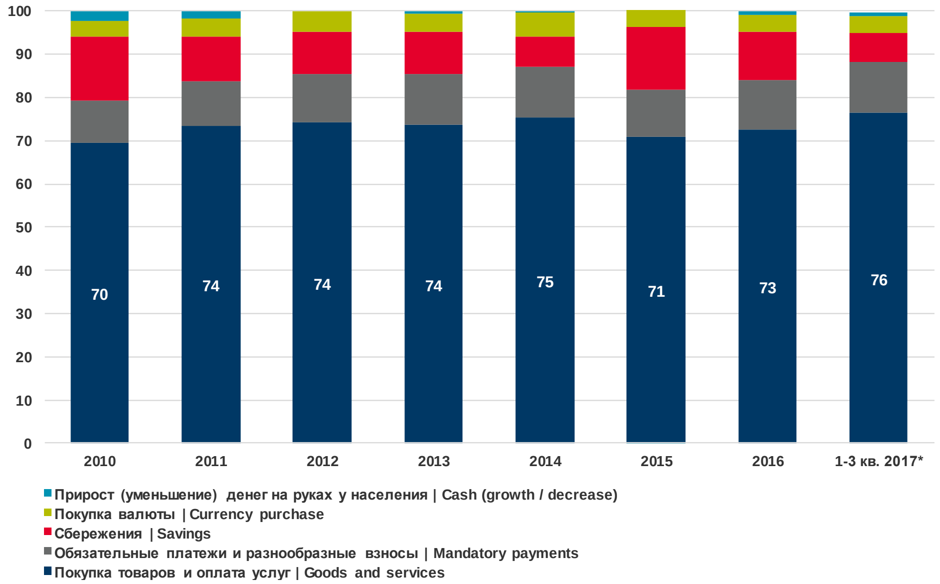
Prime rental rate indicator

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

SAVINGS ARE GRADUALLY MOVING TO RETAIL

The share of savings relative to other uses of income is decreasing markedly, while the share of spending on goods and services has returned to the pre-crisis level.

Structure of use of income, %



*preliminary results

Consumers are coming back to the shops, however they have limited financial resources. In 2017, disposable income decreased again (-1,7% compared to 2016). So, the increase of the share of spending on goods and services is connected not only to the real growth of spending, but also with the decrease in incomes amidst rising inflation.

This is the reason why this prioritization of consumption over savings hasn't had a significant effect on retail turnover. In 2017, the indicator grew by 1,2%.

RECOVERY OF THE CONSUMER MARKET

In 2017, the consumer market experienced a modest growth, according to forecasts.

Forecast for 2018

2.9 %

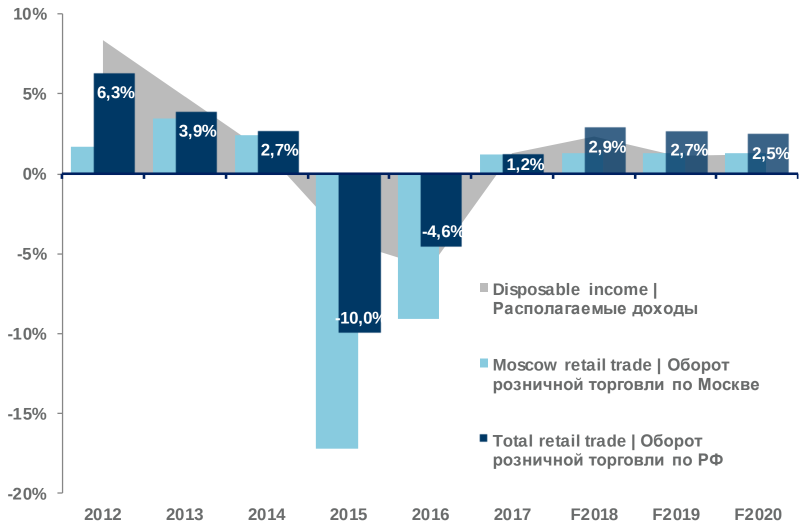
Retail turnover growth

2.3 %

Disposable income growth

Source: The Ministry of Economic Development forecast (10/2017)

Consumer market indicators



Source: The Ministry of Economic Development

In the beginning of 2017, Maxim Oreshkin while presenting the new economic forecast specified that possible scenarios include the continuation of sanctions for the next 3 years. Perhaps this is the reason why the forecast of economic development hasn't been revised for the last 6 months. Current data on the results of 2017 confirms the preliminary forecast regarding the growth of the consumer market (+1.2%). The trend is the same both for Russia and Moscow. The growth of consumer spending will be moderate in Moscow, in the regions market recovery will be more pronounced. However, taking into account the latest geopolitical events and their influence on the Russian economy, the growth in retail turnover might be less than has been noted in the current official forecast.

Retail

STABILITY IS STILL NOT LEADING TO GROWTH

New construction volume keeps decreasing against a background of risky consumer market.

THE MARKET IS IN SEARCH OF EQUILIBRIUM

A decline in vacancy rate is expected against a background of a decrease in new construction and the recovery of consumer market.

95

‘000 sq. m

New construction, Q1 2017

Russia (including Moscow)

500

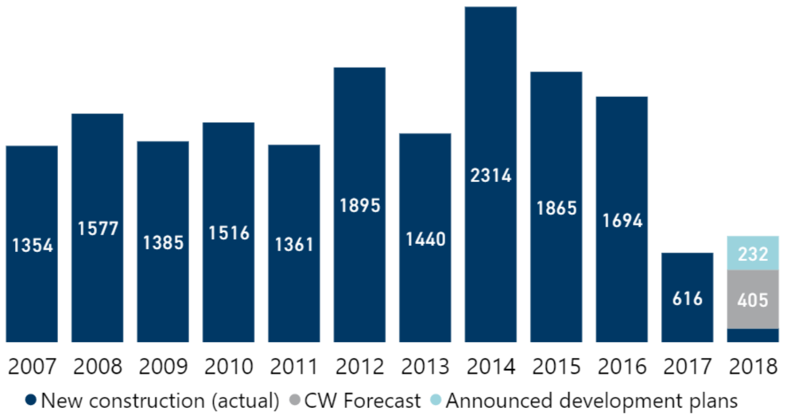
‘000 sq. m

New construction, 2018F

Russia (including Moscow)

Source: Cushman & Wakefield

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



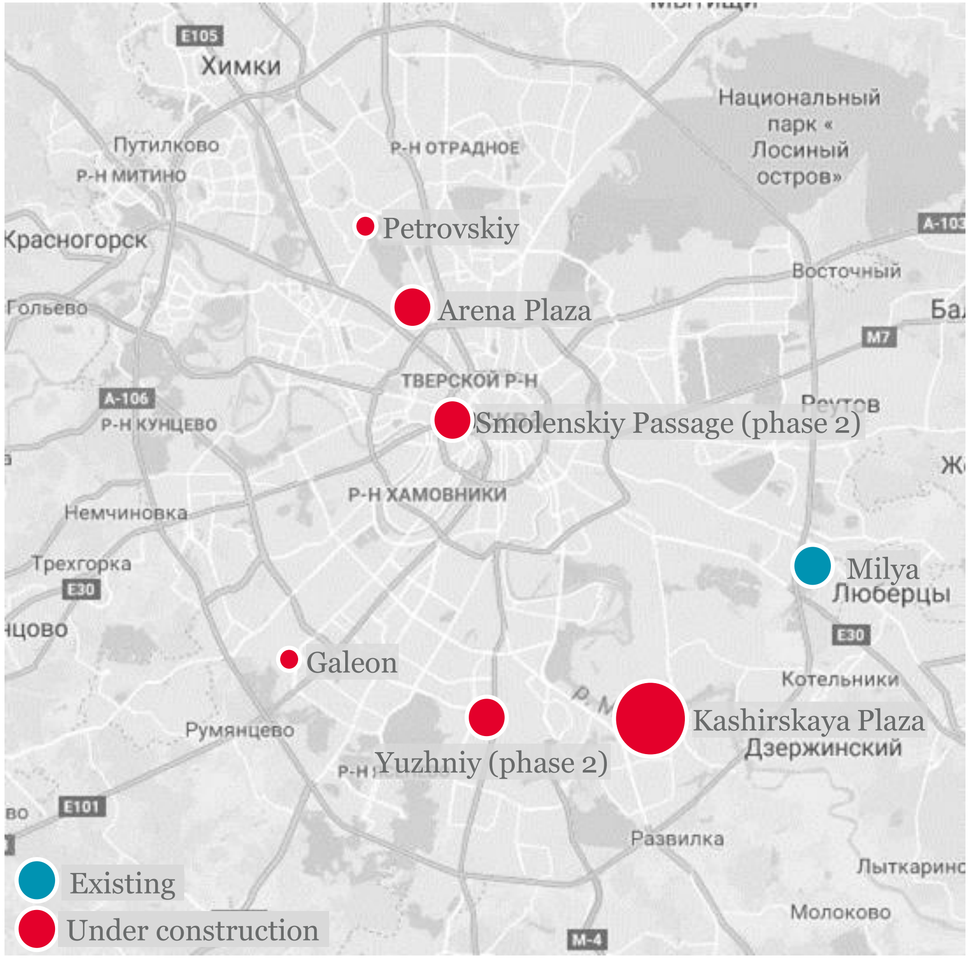
Soutce: Cushman & Wakefield

In Q1 2018, four quality shopping centers with total GLA of 95,000 sq. m were delivered to the market in Russia. The trend of the decrease of average shopping center size is now very evident – all the shopping centers opened in Q1 have GLA of less than 30,000 sq. m.

In 2018, new construction will beat an abysmal record from 2017 - around 500,000 sq. m of retail space is planned to be delivered to the market.

With the opening of Skazka shopping center (GLA – 29,000 sq. m) Krasnodar has strengthened its first position within the context of retail space saturation among cities with population of more than 100,000 inhabitants – this indicator reached 738 sq. m per 1,000 citizens.

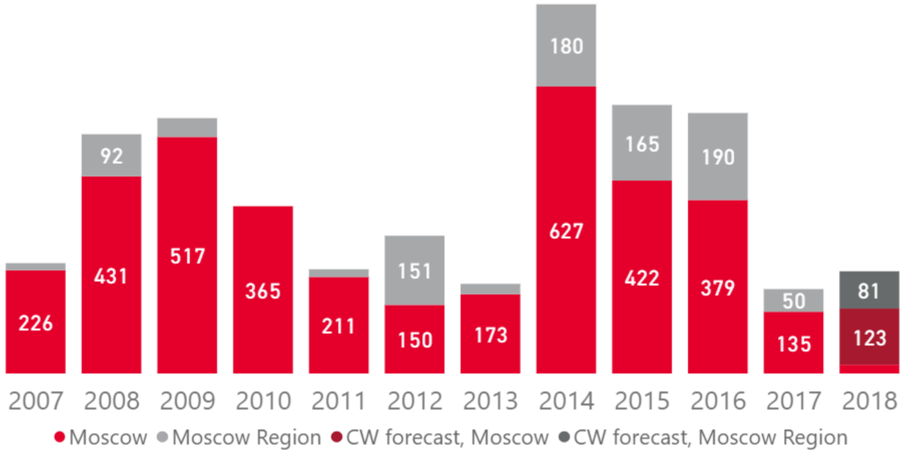
Shopping centers opened in 2018 and planned for delivery in Moscow in 2018



Retail

NEW CONSTRUCTION IN MOSCOW

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



Milya shopping center (GLA – 19,160 sq. m) was the only shopping center opened in Moscow in Q1.

By the end of the year around 220,000 sq. m of quality retail space will be delivered to the market, which constitutes almost the half of new construction volume in all of Russia.

Kashirskaya Plaza (GLA – 71,000 sq. m) is the largest shopping center planned for opening in 2018.

NATIONAL CHAINS ARE STRENGTHENING THEIR POSITIONS

Large chains are expanding their presence in the market not only by opening new stores, but also by taking over local players.

EXPANSION

Market consolidation continues – large national and international retailers are announcing plans to take over local chains (X5 Retail Group bought 99 stores of Polushka in Ufa, Okey supermarkets in St. Petersburg were taken over by X5, Leroy Merlin is considering buying Kesko and K-Rauta).

Delivery services are actively developing - Yandex.Eda is starting to operate in the regions, and Delivery Club is installing vending machines and meeting points in office centers. Delivery from grocery stores is gaining in popularity – retailers are launching their own services (Auchan) and expanding their delivery areas (X5 Retail Group); new delivery aggregators are emerging (Tashir launched Save Time application, Vezyot taxi plans to start delivering from supermarkets via its Golamago app).

NEWCOMMERS, Q1 2018

F&B is the one of the most actively developing segments, players are expanding both within the country and are also announcing international expansion plans – Black Star Burger plans to open in Los Angeles, Dodo Pizza is entering the German market, Bushe is going to the Netherlands, and the owner of Uryuk restautants launched a café in London.

COMMERCIAL TERMS

2017 represented 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 growing confidence of market players. At the beginning of 2018, the rental rate remained stable.

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 *

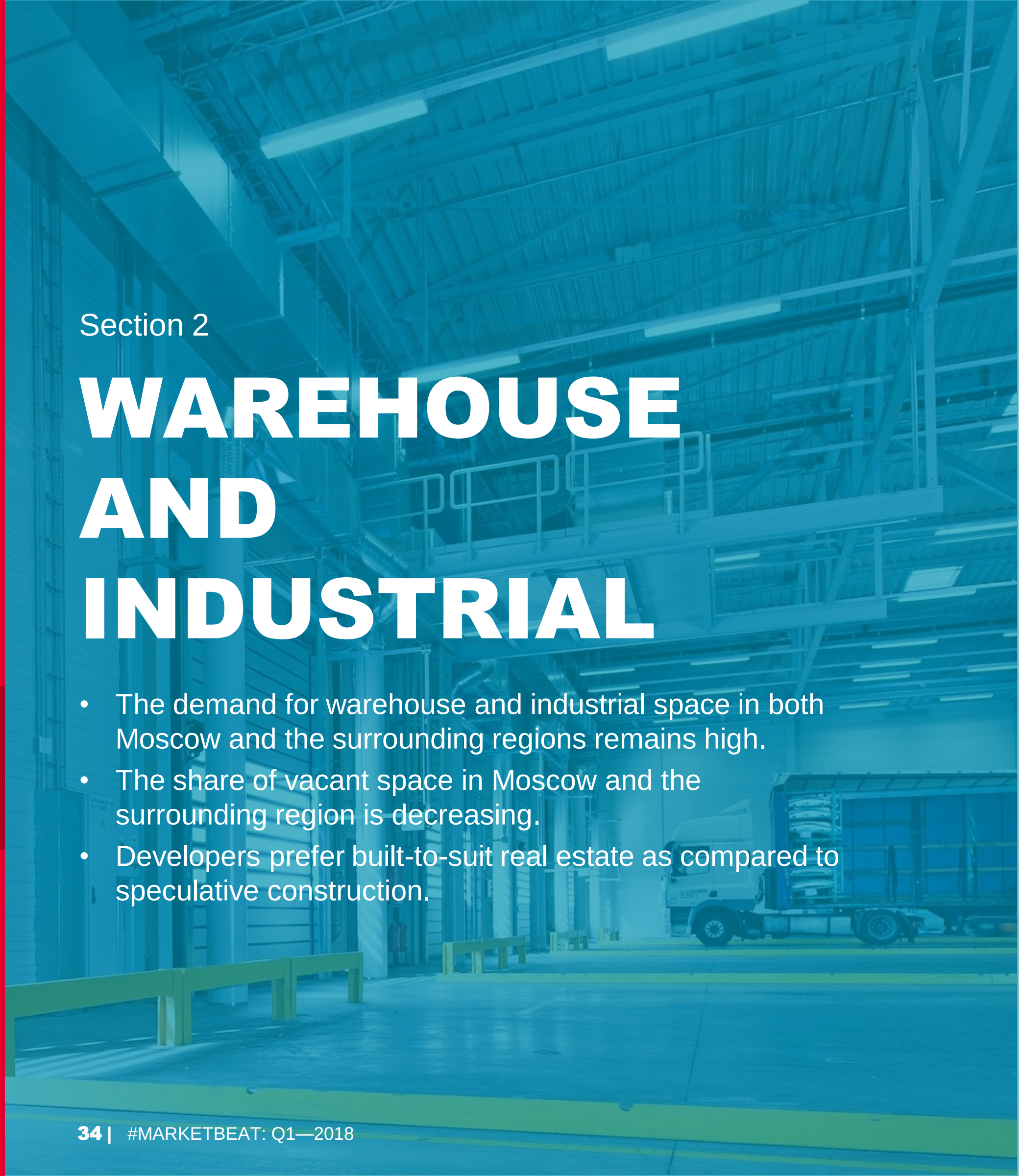
Tenant type	Average rental rate, Rub./ Sq. m / year	
	Min	Max
Hypermarket	-	8 000
DIY	-	10 000
Entertainment center	-	14 000
Cinema	6 000	12 000
Fashion (anchor)	-	15 000
Retail gallery unit	20 000	180 000
Fitness center	6 500	10 000
Restaurant, café, coffee shop	20 000	100 000
Food court	75 000	150 000

Source: Cushman & Wakefield

*Average rental rates for successful shopping centers in Moscow. The data can be used only for estimation of 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, from 3 to 5% for large anchor tenants.



Section 2

WAREHOUSE AND INDUSTRIAL

- The demand for warehouse and industrial space in both Moscow and the surrounding regions remains high.
- The share of vacant space in Moscow and the surrounding region is decreasing.
- Developers prefer built-to-suit real estate as compared to speculative construction.

MOSCOW, CLASS A

	Q1 2018	2018 (forecast)
Stock (‘000 sq. m)	9,965	10,581
New construction (‘000 sq. m)	54	571
Vacancy rate (%)	9,5	9
Rental rate * (RUB / sq. m / year)	3,300	3,300
Take up (‘000 sq. m)	408	1,200

REGIONS, CLASS A

	Q1 2018	2018 (forecast)
Stock (‘000 sq. m)	6,710	7,023
New construction (‘000 sq. m)	57	385
Take up (‘000 sq. m)	44	600

** Average rent excluding OPEX, utilities and VAT*

DEMAND FOR WAREHOUSE SPACE IS STABLE

Trends. Moscow and Regions

54

‘000 sq. m

New construction, class A

Moscow and the regions, Q1 2018

408

‘000 sq. m

Take up, class A

Moscow and the regions, Q1 2018

Source: Cushman & Wakefield

Typically, the first quarter of the year is characterized by relatively low market activity and few surprises, however Q1 2018 has proven to be an exception. The number of completed deals in the first quarter exceeded expectations.

In the Moscow region, the first three months of the year set a record in terms of the number of leased and purchased areas in quality warehouses – a total of 408,000 square meters. This number is more than double (2.3x) the average from the previous ten years. In contrast to the Moscow region, take-up in the surrounding regions totaled a mere 44,000 sq. m – two times less than the average over the past 10 years.

However, given the reports of the previous period and the general uncertainty of the current economic climate, we are not inclined rush into predictions of shifting trends and thus maintain our previously stated position.

By the end of the year, concluded transactions in Moscow and the surrounding regions will reach the levels recorded in the previous year, totals of 1.2 and 0.6 million square meters respectively.

No further surprises were noted in the remaining economic indicators of the first quarter.

In the Moscow region rental rates remain stable, the share of vacant space is decreasing, and the new construction will exceed the levels of 2017.

In the regions rates remain stable. In several regions there is an observed deficit of warehouse space, however developers are carefully considering any decisions as to the beginning of new construction projects. Built-to-suit construction continues to dominate the market – by the end of the year the growth in supply will exceed the growth measures recorded in 2016 and 2017.

Warehouse & Industrial

MOSCOW REGION

The share of vacant space is decreasing amidst low rental rates. In addition, development activity is increasing.

THE VACANCY RATE IS DECREASING

Rental rates and the vacancy rate. Moscow region

9 %

Vacancy rate, class A

Q1 2018

3,300

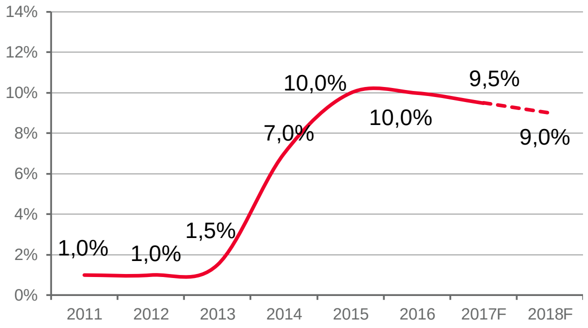
RUB / sq. m / year

Rental rate, class A

Q1 2018

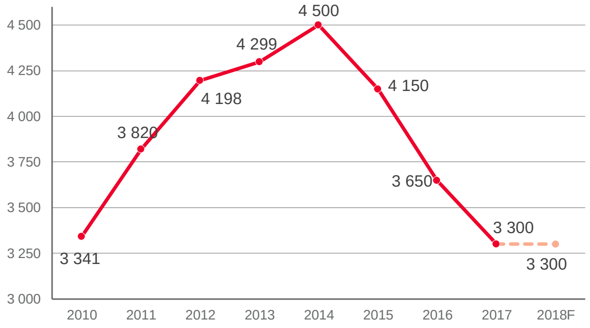
Source: Cushman & Wakefield

Vacancy rate, class A



The decrease in the share of vacant space first noted in the second half of 2017 has continued and will continue in 2018. Despite recent announcements of new ventures, developers prefer build-to-suit projects to speculative construction.

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



The average asking rental rate did not change in Q1 and was thus recorded at 3,300 rubles per square meter per year.

We do not foresee any further decrease in rental rates, at the very least until the end of 2018. These low rates are reassuring to certain large developers.

DEMAND FOR WAREHOUSE AND INDUSTRIAL REAL ESTATE HAS STABILIZED

Supply and Demand. Moscow region

102

‘000 sq. m

New construction, class A and B

Q1 2018

408

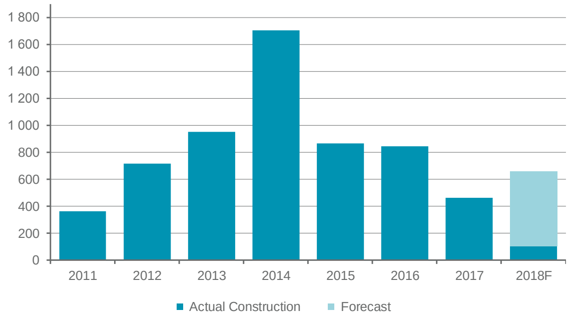
‘000 sq. m

Take up, class A and B

Q1 2018

Source: Cushman & Wakefield

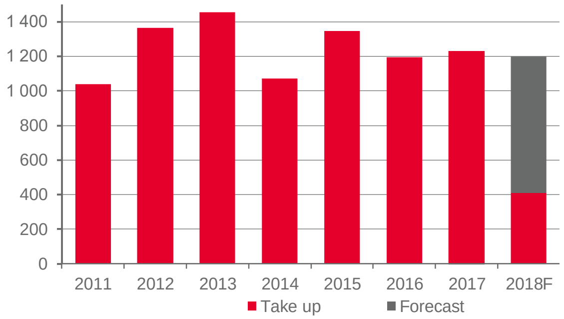
New construction, classes A and B, ‘000 sq. m



The supply of warehouse space increased by 102,000 sq. m during the first three months of 2018, which relative to the same period from 2017.

We predict that in 2018 around 660,000 sq. m of new warehouse space will be constructed, representing a 40% increase relative to 2017.

Take up, classes A and B, ‘000 sq. m



In Q1 2018, 408,000 sq. m of warehouse space was rented and purchased, more than doubling (2.4x) the recorded total from the same time period in 2017. The low growth rate of the consumer market limits the growth of demand for warehouse projects. Thus we predict that the take up will match the previously recorded level from 2017, for a total volume of 1.2 mn sq. m.

Warehouse & Industrial

REGIONS OF RUSSIA

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

SEVERAL REGIONS HAVE RECORDED A DEFICIT

Supply and Demand. Regions

57

'000 sq. m

New construction, class A and B

Q1 2018

44

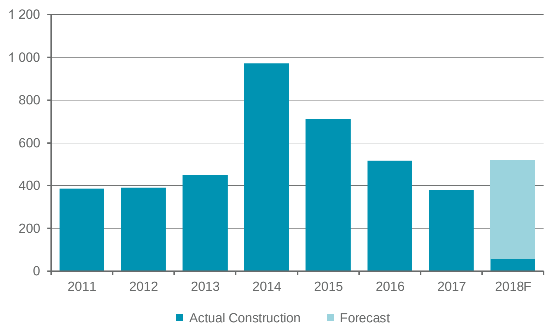
'000 sq. m

Take up, class A and B

Q1 2018

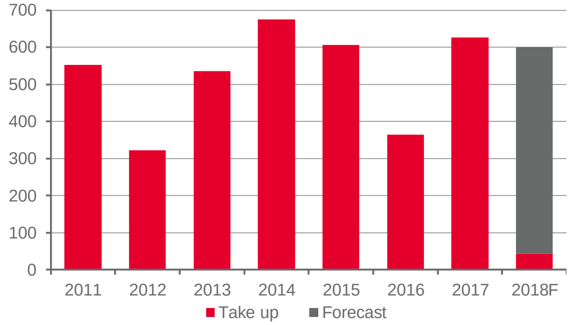
Source: Cushman & Wakefield

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



In the first quarter 57,000 sq. m of new warehouse space was constructed, a decrease of 15% from the previous year. It is, however, too early to declare decrease in the rate of new construction. In a number of regions there is a deficit of quality warehouse space. Based on the preliminary results, approximately 510,000 sq. m of space will be constructed by the end of the year – a 35% increase over the previous year.

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



In Q1 2018, 44,000 sq. m of warehouse space was leased or purchased, an amount that is more than four times smaller than the amount recorded from the previous year. Given that this quarterly indicator is relatively volatile, and the demand for industrial space stable, we are not changing our forecast for 2018. Based on the preliminary results, the take up will reach 600,000 sq. m.

KEY PROPERTIES

Supply and demand. Moscow and regions

Key warehouse properties opened in Q1 2018, and planned for delivery by the end of 2018

Property	Highway	Region	Distance from city, km	Total area, 000 sq. m	Delivery
Vnukovo - 2	Kievskoe	Moscow	17	38,6	Q1
Wildberries	Simfelopolskoe	Moscow	20	95	Q3, Q4
IKEA Yesipovo	Leningradskoe	Moscow	33	90	Q4
Mikhaylovskaya Sloboda	Novoryazanskoe	Moscow	20	46,9	Q2, Q4
PNK Park Sofyino	Novoryazanskoe	Moscow	32	34,8	Q2
Logopark Sigma		Ufa		24,5	Q1
A Plus Park Kazan		Kazan		58,7	Q1, Q3
Monetka		Khanty-Mansiysk		25,7	Q3
Oktavian	Toksovskoe	St. Petersburg	11	28,5	Q2, Q4
A2 Logistic Krasnodar		Krasnodar		10	Q3

Section 2

HOSPITALITY

- As Q1 2018 results demonstrated, Wider market Occ rate continues to climb (7.5% vs. the same period in 2017) – at the expense of ADR which shrank 2.3% (in RUB) relative to Q1 2017, likely due to the expansion of the market during the previous year.
- The only observed growth in supply recorded in Q1 was in the airport submarket – a trend that is expected to continue in 2018.
- Moscow is gearing up for the 2018 World Cup, that is expected to attract up to 1 million foreign visitors.

~60 `000 keys

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

City of Moscow's and Cushman & Wakefield's estimates, Q1 2018

19.3 `000 keys

Modern quality room stock

Cushman & Wakefield's estimates, Q1 2018

549 keys

In 2 new hotels

Net room stock increase over 2018

344 keys

In 2 new airport hotels

Net room stock increase in Q1 2018

THE MORE AIRPORT HOTELS, THE MERRIER

Main supply increase – in the airport submarket.

549 keys

New supply in Moscow in 2018

2 new hotels

70 %

Bulk of added stock in Moscow

Upper-Upscale segment

1 026 keys

New supply at Moscow airports in 2018

4 new hotels

Source: Cushman & Wakefield

New supply in Moscow in 2018

Project	Keys	Opening
Radisson Blu Olympiysky	379	Q2
Holiday Inn Express Khovrino (ex-Sozyuz)	170	Q2
Total	**549**	

New supply at Moscow airports in 2018

Project	Keys	Opening
Ibis Moscow Domodedovo Airport	152	Q1
Holiday Inn Express Moscow - Sheremetyevo Airport	192	Q1
DoubleTree by Hilton Moscow – Vnukovo Airport	432	Q2
Four Points by Sheraton Moscow – Vnukovo Airport	250	Q4
Total	**1.026**	

HOTEL SUPPLY GROWTH IS SLOWING DOWN - TEMPORARILY

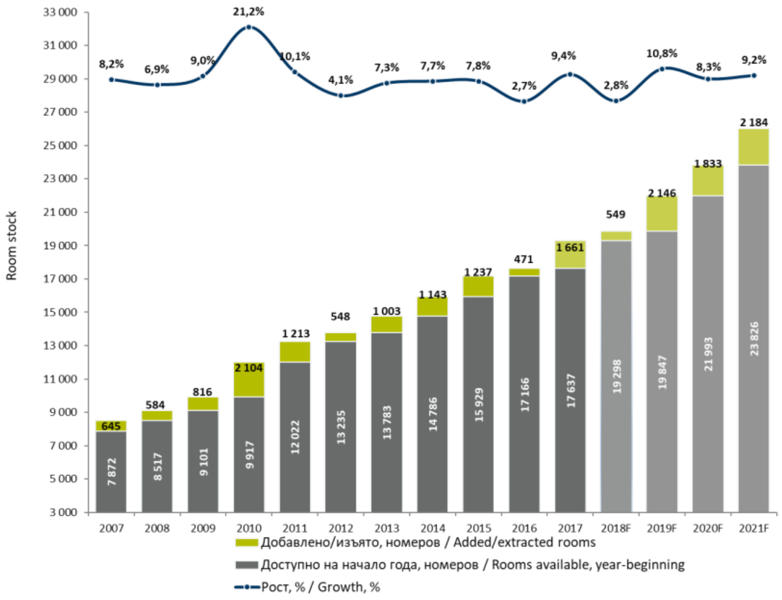
Growth rates are lower than in 2017 – but there is no reason to worry yet.

2.8 %

Year-to-year growth in 2018

Expected market growth rate vs. 2017

Supply growth dynamics – actual and projected



Source: Cushman & Wakefield

After a substantial growth of room stock in 2017, 2018 is expected to see a lower number of openings, with the total number of new keys limited to 549. Unlike a year before, the new hotel rooms will be mostly of a high grade, which is likely to negatively affect the fragile balance of rates in the market.

At the same time, should all hotel projects currently in development open on schedule, this slowdown of supply growth may prove to be short-lived, and growth rates will return to levels exceeding 8% per annum as soon as in 2019.

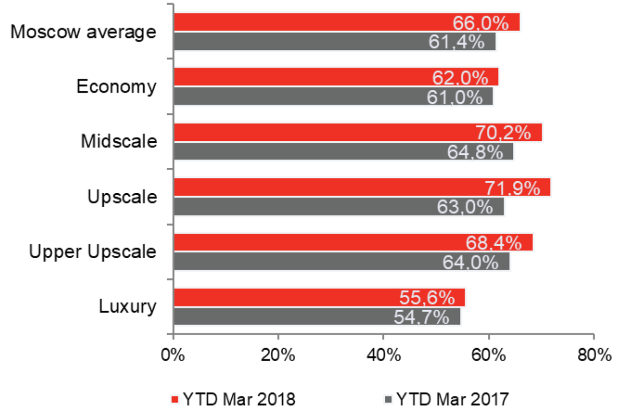
DEMAND GROWTH IS OUTPACING ROOM RATES

Occupancy and ADR changes are still moving in different directions.

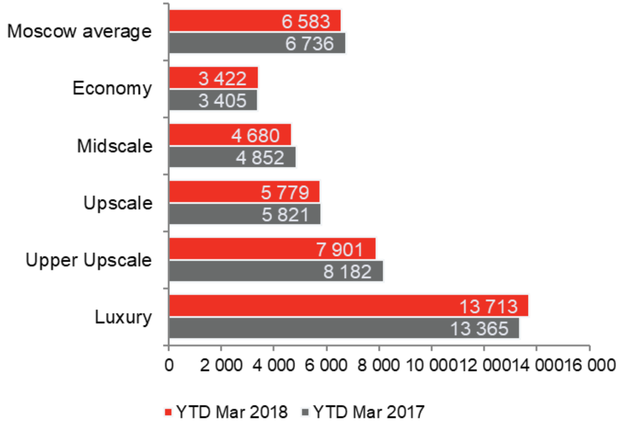
66.0 % Occ, Q1 2018
Wider market

-2.3 % ADR (RUB) change, Q1 2018
Wider market

Occ, Q1 2018, by segment



ADR (RUB), Q1 2018, by segment



Source: Cushman & Wakefield

Over Q1 2018, the Wider market Occ rate increased 7.5%, or 4.6 percentage points (ppts) year-to-year, reaching 66.0%. The real drivers of this increase were Upscale hotels (increase of 8.9 ppts), the segment which did not add any new rooms in 2017.

Growing demand and increasing hotel occupancy, however, did not stimulate room rate growth. This could be due to a number of reasons, including a more even distribution of hotel occupancy throughout the week, to include weekends (a trend driven mostly by domestic tourism) as well as an assortment of hotel room openings in 2017, predominantly in the Economy and Midscale segments, which could be still selling rooms at lower rates than stabilized properties. One way or another, the market-wide ADR in Q1 2018 dropped by 2.3% year-to-year, decreasing from RUB6,735 to RUB6,583. The only price segments which displayed the opposite trend were Luxury and Economy hotels – their ADRs grew by 2.6% and 0.5%, respectively.

REVPAR GROWS, DRIVEN BY OCCUPANCY INCREASES

5.1 %

Q1 2018 RevPAR change (in RUB)

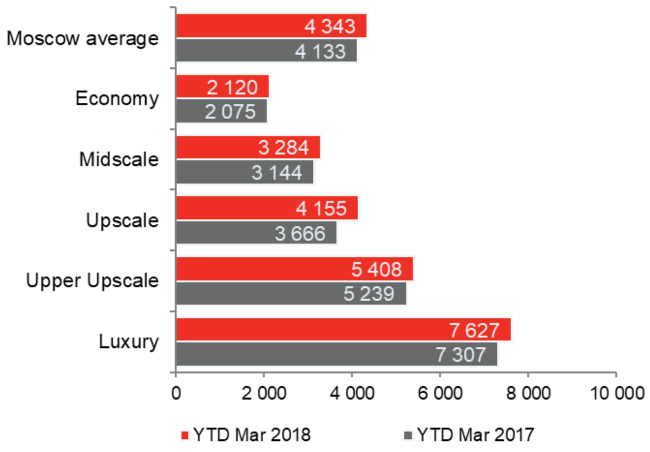
Wider market

13.4 %

Highest RevPAR growth in Q1 2018

Upper-Upscale segment

RevPAR (RUB), Q1 2018, by segment



Source: Cushman & Wakefield

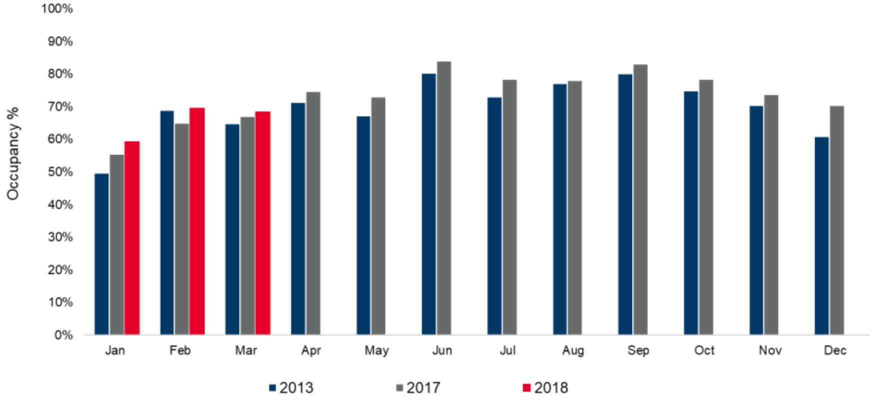
Despite a negative correction of ADR across the Wider market, strong demand for hotel accommodations still lead to a 5.1% year-to-year growth in room yields (RevPAR), RUB4,343/room.

Several price segments displayed more impressive results: Upper-Upscale hotels improved their RevPAR by 13.4%, and Midscale and Luxury hotels – by 4.5% and 4.4%, respectively.

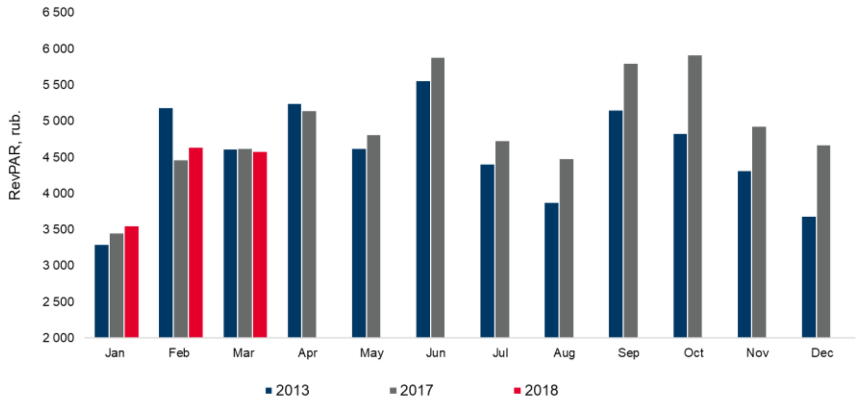
READY, STEADY, GO

Slow start of the year – in line with Moscow market's patterns, the market gearing up for Q2 2018.

Occupancy dynamics, %, by month



RevPAR dynamics (in RUB), by month



The slow start of 2018, when compared to the same periods in 2017 and 2013 (the 'benchmark year') is fairly traditional for the Moscow market. Monthly occupancy patterns are generally in line with previous year's occupancy rates, and strong demand for hotel rooms allowed city hotels to compensate for the negative trends in ADR, pushing the RevPAR indicator up.

The results of the second quarter, which are typically more dynamic and profitable for Moscow hotels, will be dominated in 2018 by the World Cup. Hopefully, the recent spate of political and economic events in the run-up to the upcoming 2018 World Cup, to be hosted by Moscow and 10 other Russian cities, will not damper the enthusiasm of the true fans of this international football fest.

The effects of the World Cup as well as any initial conclusions as to any effect on the market will be first become evident at the end of the second quarter.

Source: Cushman & Wakefield

#MARKETBEAT

Section 3

APPENDIX

Information and interactive maps

STANDARD COMMERCIAL LEASE TERMS

LEASE TERMS

DURATION OF LEASE

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

BREAK OPTION

Offices: Possible after 3 years with 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%

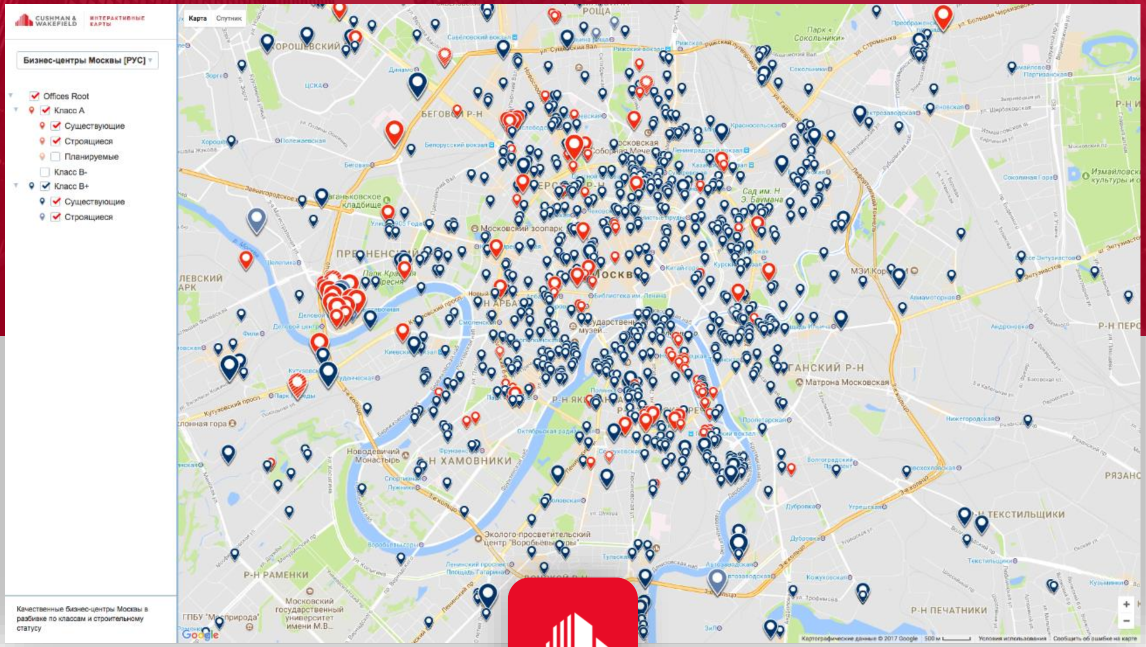
Cushman & Wakefield in Russia

INTERACTIVE MAPS

PROPERTY SEARCH

www.interactivemaps.ru

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



COMMERCIAL REAL ESTATE AND INFRASTRUCTURE INTERACTIVE MAPS

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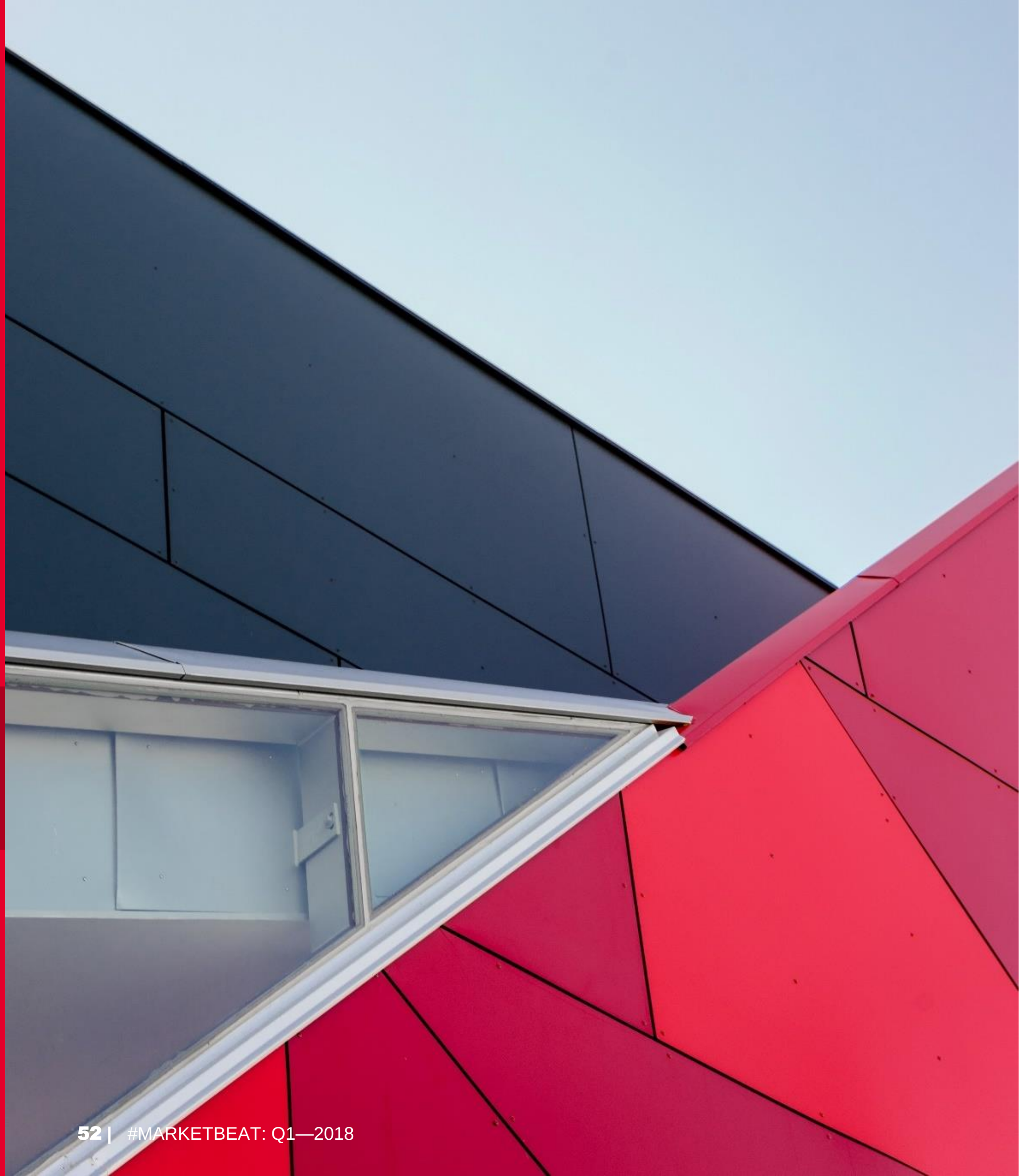

About the company

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.

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