

Commercial Real Estate - Russia

# #MARKETBEAT

Cushman &amp; Wakefield Research Department

Jul '19

Macroreview

Capital Markets

Office

Retail

Warehouse &amp; Industrial

Hospitality &amp; Tourism

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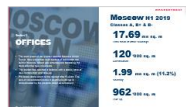
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*Section 1*

# NATIONAL PROJECTS ARE THE NEW OIL

National projects are intended to ensure balanced development and social stability. Private initiatives within national projects can rely on the government support.



## BRIEFING: BREAK OUT FROM THE BOTTOM

In Q2 2019, the real estate market revived after a calm period in Q1. However, a slowdown in the economy can dampen the positive momentum.

In the second quarter, b2b markets showed moderate optimism. Business has adapted to the VAT increase, high cost of money, and low inflationary pressure.

In Q2, economic growth slowed down. However, the authorities are not concerned as national projects are currently considered to be an important factor for the development of the economy. While their full effect will not be evident earlier than 2020.

In fact, the government proposes a model of consolidation and nationalization of budget-forming industries and development balance with the help of national projects.

With this in mind, businesses should form their strategies in accordance with the requirements of national projects.

The consumer market remains as the main risk zone for Russia. Russia, as it did as the USSR, will soon face the question whether it is possible to ensure economic growth with only national projects and industry, and without regard for the consumer sector.

In modern cities, consumption creates an additional price for commercial real estate properties. As an alternative, the development of non-commercial public spaces has been proposed, which on one hand is good for the city, and on the other creates an additional financial burden.

Therefore, there is a risk to transition to a costly, planned-unprofitable model of the city, in which financial gaps grow, and the disparity between prosperous and problem areas increases.

### IMPORTANT

- The revival of the investment market. Will the momentum continue in Q3?
- Will the slowdown of the economy lead to a cooling of the real estate market?
- Will the growth rates of household debt slow down?

## Section 1

# MACROREVIEW

- Minor revision of indicators downwards.
- Negative expectations are “included” in the price.
- Cooperative housing reform came into effect.
- Low business activity in the real estate market.
- National projects have become a priority in the governmental strategy.

## MACRO INDICATORS

	2018	2019	2020	2021	2022
GDP growth, %	2.25	1.02	2.45	1.63	1.28
RUB/USD	62.67	65.06	63.95	63.06	62.84
CPI, %	2.88	4.68	4.06	4.67	4.00
GDP deflator, %	12.14	8.88	5.76	3.70	3.65
Interest rate, %	8.87	9.68	9.02	8.69	8.41
Current Balance, % of GDP	3.03	2.56	1.47	1.27	0.99
Private consumption, %	2.30	1.70	1.78	1.99	1.89
Government spending	0.29	1.48	0.29	0.49	0.56
Capital outflow, bn USD	-3	-128	-87	-75	-68
Unemployment rate, %	4.80	4.38	4.07	3.94	3.84
BRENT crude oil price	71.1	66.5	63.8	62.1	63.0

Source: Oxford Economics 12/06/2019

# CONTROVERSIAL STATISTICS

Macroeconomic indicators showed signs of slowdown in Q2 2019. Oxford Economics significantly adjusted the forecast for GDP growth in 2019 to 1%.

Inflation continues to decline.

## 1.3 %

### GDP Growth for 2019

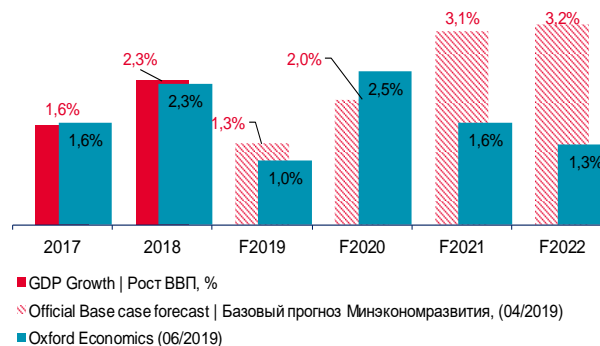
By the Ministry of Economic Development

## 4.7 %

### Inflation outlook for 2019

By the Ministry of Economic Development

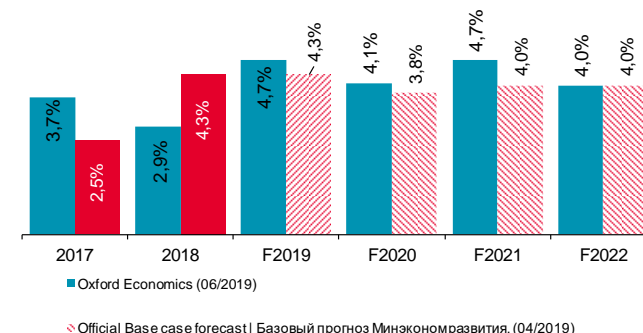
#### GDP Growth, %



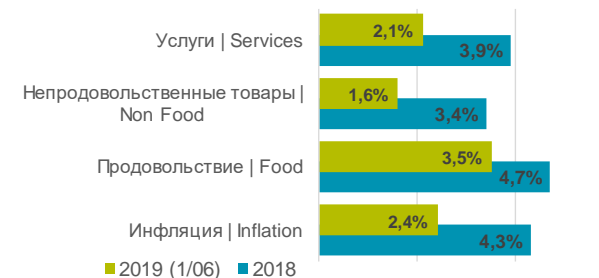
The differences between Russian and foreign sources in assessing the future of the economy continue to widen. Even within the country, the Ministry of Economic Development and the Central Bank have recently shown different views on the current state and prospects of the economy.

Food products remain the main generator of inflation, while prices for services and non-food products are rising more slowly. This means that consumers continue to redistribute their spending, giving up unnecessary costs.

#### The Consumer Price Index, %

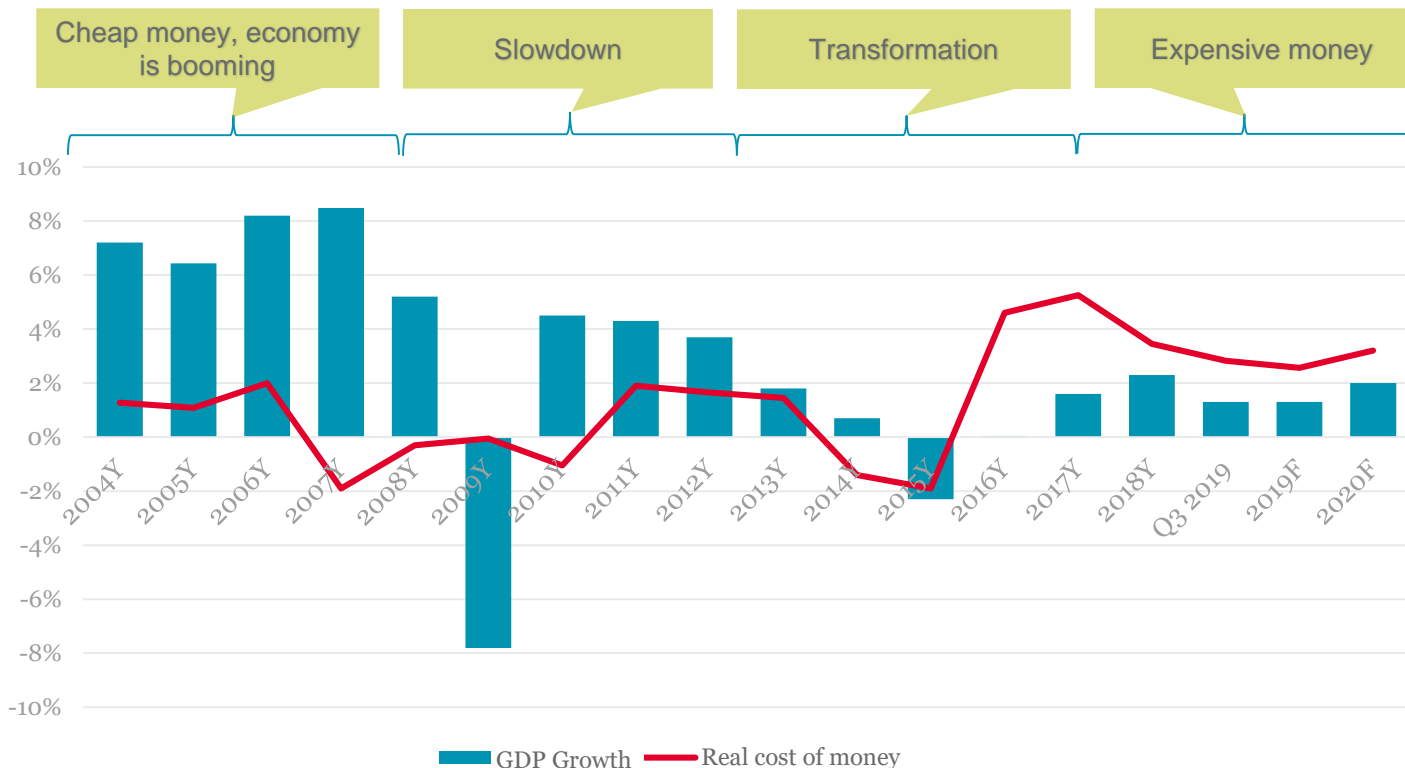


#### Inflation (Jan-May 2019)



# 2017-2020 – PERIOD OF EXPENSIVE MONEY

Real estate market stagnation



The difference between the lending rate and inflation is used to indicate the real cost of money.

Since 2017, a period of expensive money and low economic growth has begun.

This has resulted in the emergence of concessional financing for priority projects, since commercial rates will be available only for high margin projects.

Foreign capital, which in the era of the economic boom provided an inflow of cheap loans, is not available now. Competition in the financial market will continue decreasing.

# THE CREDIT BOOM CONTINUES

2019 had started with active growth of household debt, including both mortgage and consumer credits. The length of the mortgage term increased significantly, which allowed banks to increase the credit burden on households while the annuity payment remains the same.

## 12 %

Of mortgage debt was paid ahead of the term

In 2018

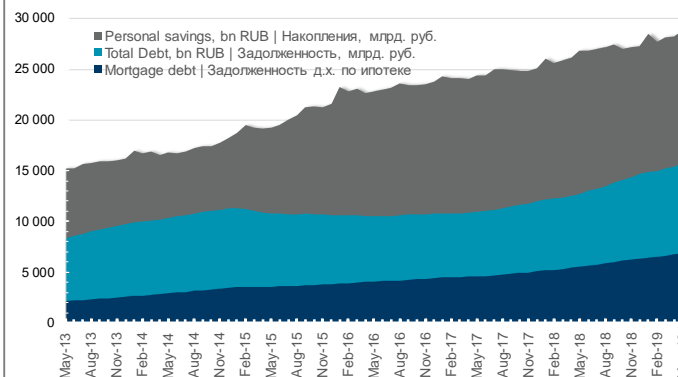
## 6 %

Share in GDP

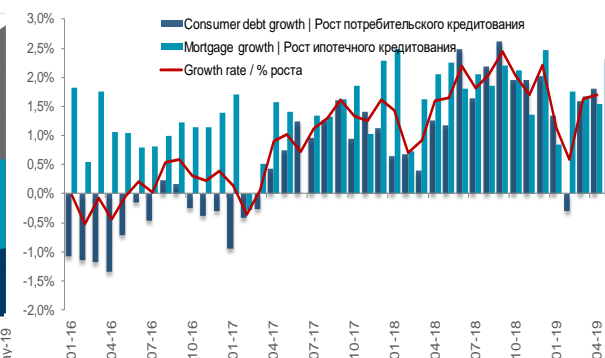
Of the mortgage debt in Russia

Source: the Central Bank, Cushman & Wakefield calculations

Shares and deposits (of physical persons), bn RUB

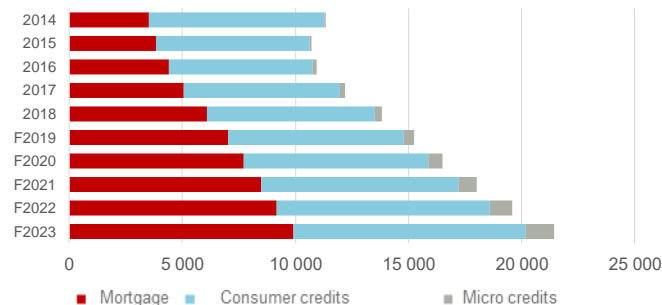


Growth rate of household debt



Despite the panicked rhetoric by the Ministry of Economic Development, there are no signs of a credit bubble in the consumer market. The share of overdue debt is declining. However, the growth of household debt depletes the consumer market, which, in turn, affects the employment and incomes of the service class.

Household debt structure, bn RUB





# CREDIT SQUEEZE

In 2019, the growth of corporate debt ceased, primarily due to the reduction of foreign currency debt. This means that in Q3 the revival in the real sector of the economy shouldn't be expected.

## 7.5 %

Key Rate

Increased by 0,25 in June 2018

## 22 %

Overdue Debt

In Real Estate sector



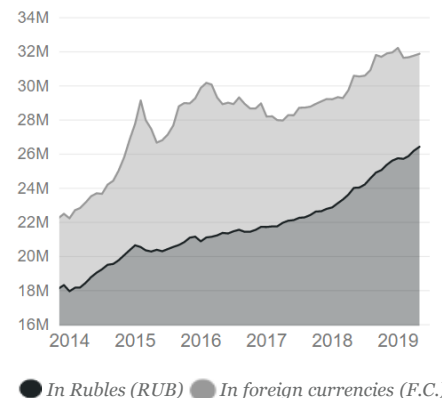
Source: The Central Bank of Russia

Construction and real estate are still in the credit compression stage. The transition to project financing of housing construction may spur the growth of the credit market in construction, but this will occur gradually, and most likely we will not see the effect earlier than 2020.

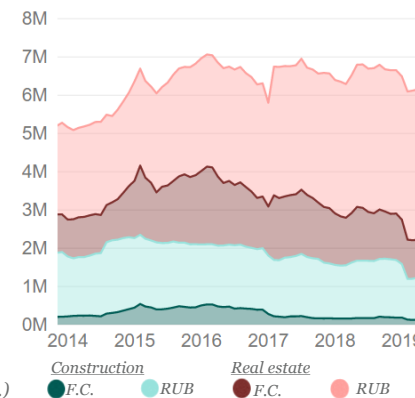
Debt growth in the wholesale and retail trade has stopped. The retail market is trapped between declining household incomes on one hand, and rising costs, on the other. In this situation, the industry has switched to austerity mode, thus reducing storage stocks and cheapening the assortment.

### Corporate debt and overdue debt, mn RUB

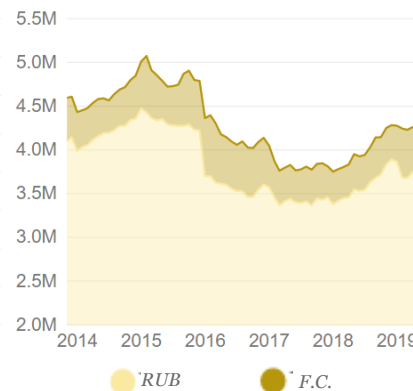
Total debt



Construction and real estate



Overdue debt



# PUBLIC RETAIL AND DEVELOPMENT COMPANIES

Stock Market Indicators from 01/04/19 to 28/06/2019 as compared to the MICEX index

● Stock prices ● MICEX index

## +20.4%

LSR

The growth leader over the past 90 days

## -7.2%

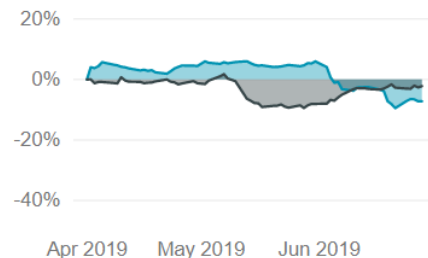
Lenta

The largest fall for the period of 90 days

Lenta

LNTA

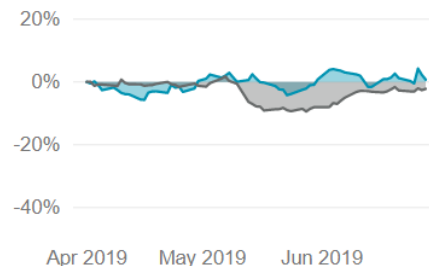
-7.2%



Magnit

MGNT

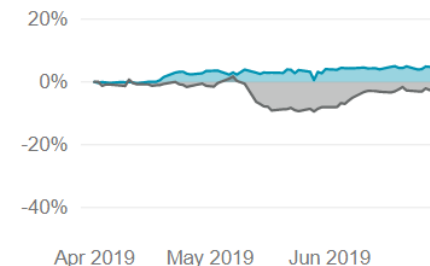
0.7%



M.video

MVID

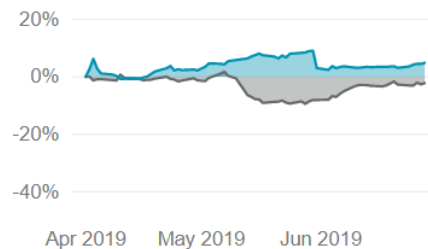
4.7%



PIK

PIKK

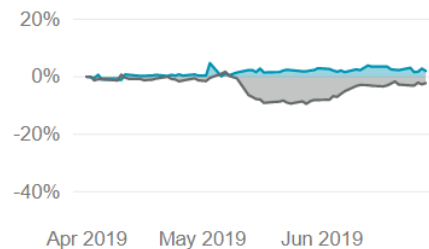
4.8%



Sistema Hals

HALS

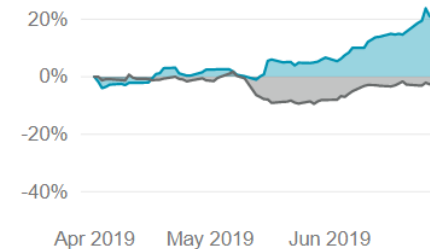
2.0%



LSR Group

LSRG

20.4%



Source: MICEX, Yahoo Finance

## Section 2

# CAPITAL MARKETS

- Market had reached its bottom.
- Capitalization rates did not react on key rate decrease.
- Investment market compression will cause a growth of the capital rates.
- Ice age will continue through 2019.
- Foreign investments continue to flow out of the market.

## 660 mn EUR

Total investment volume in Russia

In H1 2019

## 2.5 bn EUR

Total investment volume in Russia

Forecast for 2019

## 9.5 %

Capitalization rate, prime office segment

July 2019

## 61 mn EUR

Net outflow of foreign investment in H1 2019

*Capital Markets*

**INVESTMENT ACTIVITY SLIGHTLY INCREASED IN Q2, BUT IT IS STILL FAR FROM THE MARKET RECOVERY.**

The recovery of investment activity will be accompanied by a change in capitalization rates.

# EASTERN EUROPE: SLOW START

In Q2, the investment market gained momentum, decreasing the gap from the last year to 17%.

## -17%

CEE investments in H1 2019

Compared to H1 2018

## 2.2 bn EUR

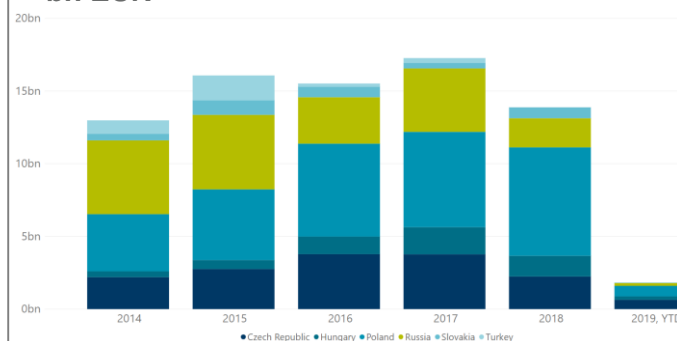
Investment volume in Poland in 2019

The largest investment market in CEE region since 2016

**REAL** CAPITAL ANALYTICS

Source: Real Capital Analytics

Investments in the core CEE markets, bn EUR

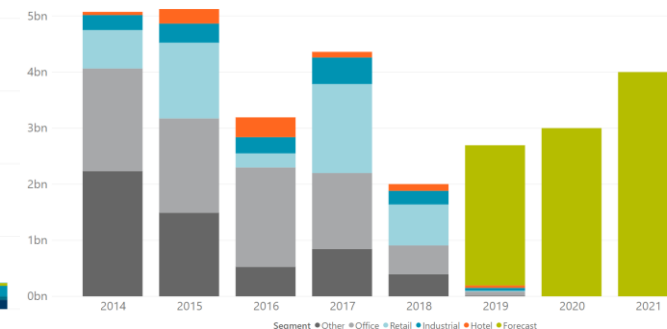


CEE markets attracted 5.8 bn Euro of investments in H1 2019, which is 17% lower than in H1 2018.

Poland is still leading in the region with 2.2 bn Euro of investment.

In CEE markets, 63% of investments are foreign, with 24% coming from outside of Europe.

Investments in Russia, bn EUR



After the investment market decrease in 2018, the Russian market hit the bottom during Q1 2019. In Q2 2019, investment activity slightly increased. Russia attracted 660 million Euros in H1 2019.

We expect that the market will become more active in the summer and fall, and that the total investment volume will reach 2.5 billion Euros by the end of the year.

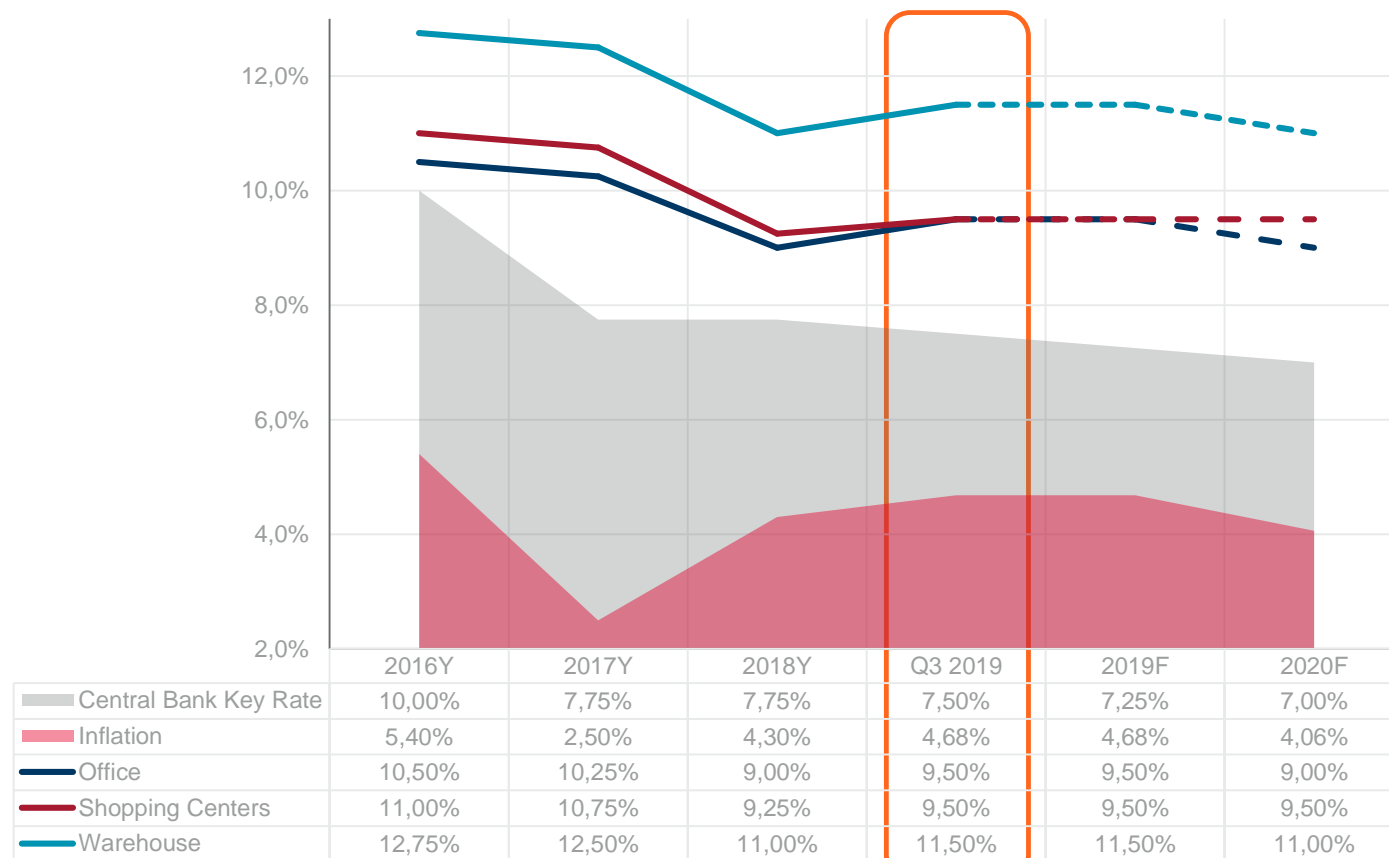


## CAPITALIZATION RATES

9.5 %

Office  
Capitalization rate

7.5 %

The key rate  
The Central Bank of Russia

## Section 2

# OFFICES

- The main event of the quarter was the Moscow Urban Forum. New properties in all sectors of real estate are built in Moscow. Mixed use schemes are becoming the most effective type of projects.
- The market has reached a balance with a stable pace of new construction and take-up.
- Pre-lease deals return to the market after 5 years. The lack of consolidated blocks in existing buildings is compensated by the projects under development.

## Moscow H1 2019

Classes A, B+ & B-

**17.69** mn sq. m

Total stock of office buildings

**120** '000 sq. m

Construction

**1.99** mn sq. m (11.2%)

Vacancy

**962** '000 sq. m

Take-up

*Offices*

# RETURN OF PRE-LEASE DEALS

Tenants have responded to the lack of consolidated office blocks with pre-lease deals in properties under development.

Despite the fact that new buildings are opening in the market, the vacancy rate remains stable.

## NEW SUPPLY

Developers feel confident in a stabilizing market that leads to growth of construction activity. In the coming years, new construction will remain in the range of 300,000-350,000 sq. m annually.

# 120

## '000 sq. m

**New construction**

In H1 2019

# 350

## '000 sq. m

**New construction**

In 2019F

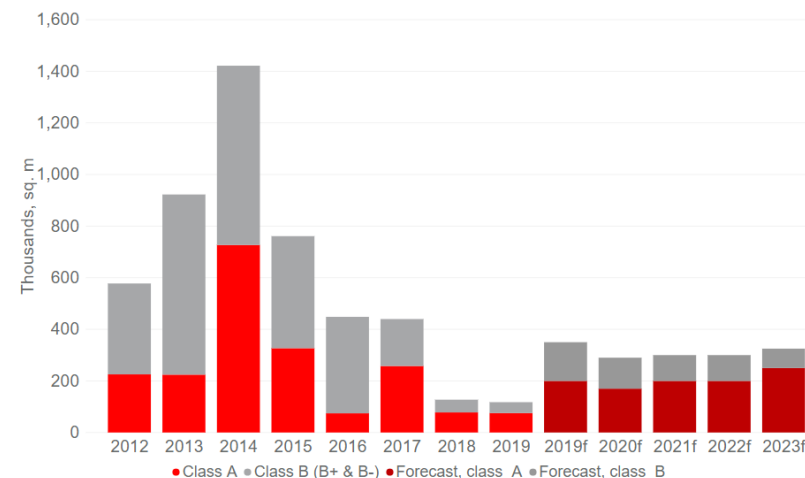
In H1 2019, 7 office buildings were delivered into the market, totaling 120,000 sq. m (4 of them in Q2 – 92,000 sq. m). Construction volume in H1 2019 is comparable to the total of 2018 (127,000 sq. m). Class A business center Iskra-Park (62,268 sq. m) was the largest opening of Q2. It is the first large office building (more than 30,000 sq. m) opened in the past year and a half (2018-2019). The required consolidated office blocks within the Moscow Ring Road are back to the market.

The northwest submarket continues to develop actively. More than 70% of office space planned for delivery to the market in 2019 is located here.

In 2019, the new construction will more than double compared to the 15-year record low last year, totaling about 350,000 sq. m.

Through 2019 – 2021, 900,000-950,000 sq. m of new office space will be delivered into the market, of which about 600,000 sq. m will be class A.

**New construction, class A and B**



Source: Cushman & Wakefield

## DEMAND

In H1 2019, take-up remains at the level of 2018. Pre-lease deals make up a significant share in the demand structure. The active development of flexible workspace makes this segment one of the most active sectors in demand structure.

# 962

## '000 sq. m

Take-up (lease and sale deals)

In H1 2019

# 1.95

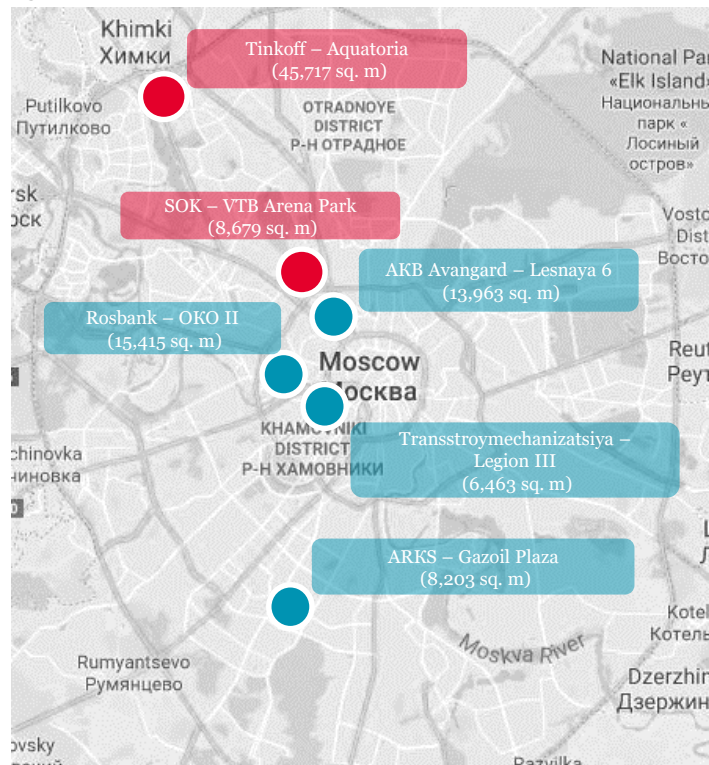
## mn sq. m

Take-up (lease and sale deals)

2019F

Source: Cushman & Wakefield

### Major deals in H1 2019



There was no significant decline in take-up after the record high in 2018. Take-up in H1 2019 is comparable to the indicator in 2018, 962,000 sq. m and 950,000 sq. m respectively. The level of demand is supported by an increase in the number of pre-lease deals.

Due to the limited supply of high-quality large blocks in sought-after properties, tenants are increasingly considering the option of signing pre-lease contracts for buildings in pipeline.

The largest deals in the sector were PJSC “Rosbank” in the business center OKO II, and JSC “Tinkoff Bank” in the business center Aquatoria. This explains the growth in the share of deals of more than 3,000 sq. m, growing from 17.2% in 2018 to 26% in H1 2019.

Due to the development of flexible workspace industry, the sector is becoming one of the most active on the market regarding the share of closed deals (6.4%). However, the undisputed leaders are still companies from the banking and financial sector, which exceed this figure by almost 5 times (31%). Deals of construction and IT companies accounted for 4.7% and 3.9% of the total take-up.



# VACANT OFFICE PREMISES

At the beginning of 2019, vacancy rate increased due to the delayed effect of premises entering the market after a record high take-up in H2 2018. Despite the increased new construction, healthy demand holds the vacancy rate at 11%.

# 11.2%

Vacancy rate in H1 2019

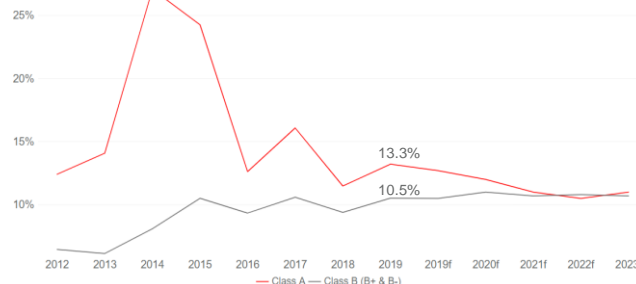
Classes A and B (B+ & B-)

# 1.99 mn sq. m

Vacant premises in H1 2019

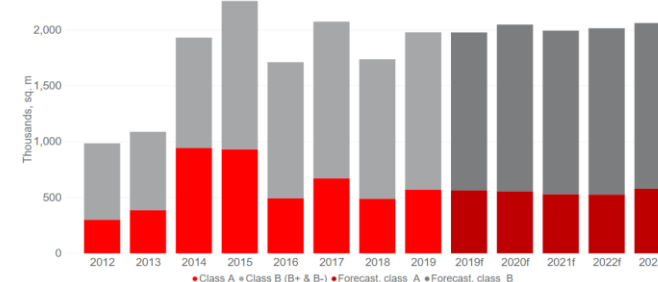
Classes A and B (B+ & B-)

Vacancy rates



The vacancy rate has been growing since the end of 2018, despite healthy demand from tenants. At the end of Q2 2019, the vacancy rate amounts to 11.2% (class A - 13.3%, class B - 10.5%), which is 1.3 p.p. higher than at the end of 2018 (9.9%), when we saw record high take-up. The increase in vacancy is associated with the stabilization of demand and the increase of new construction (in H1 2019 the new construction equaled 90% of the last year volume). Despite higher levels of new construction for the next 3 years, new premises will be occupied by tenants. The vacancy rate will keep at ~ 11%.

Vacant premises



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

The vacancy rate in New Moscow continues to decline gradually. Tenants take advantage of the opportunity to take quality offices at cheaper rates than in the Central Business District.

Source: Cushman & Wakefield

# ABSORPTION

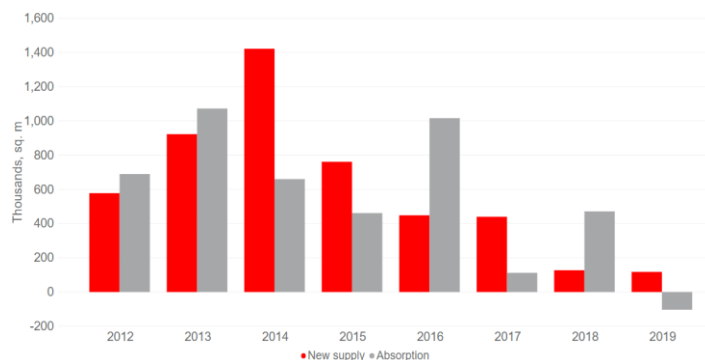
Office space that became vacant after a record high take-up in 2018 entered the market in early 2019. In H1 2019, office premises began to be absorbed. By the end of the year, we expect absorption to return to the positive zone.

In the coming years, absorption will remain positive.

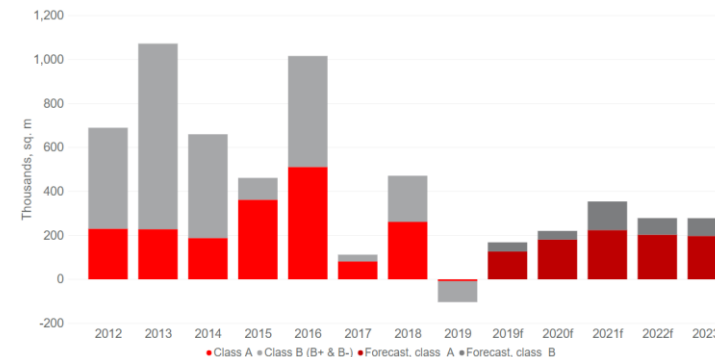
**-108**  
'000 sq. m

Absorption in H1 2019

### Absorption and new construction



### Absorption by class

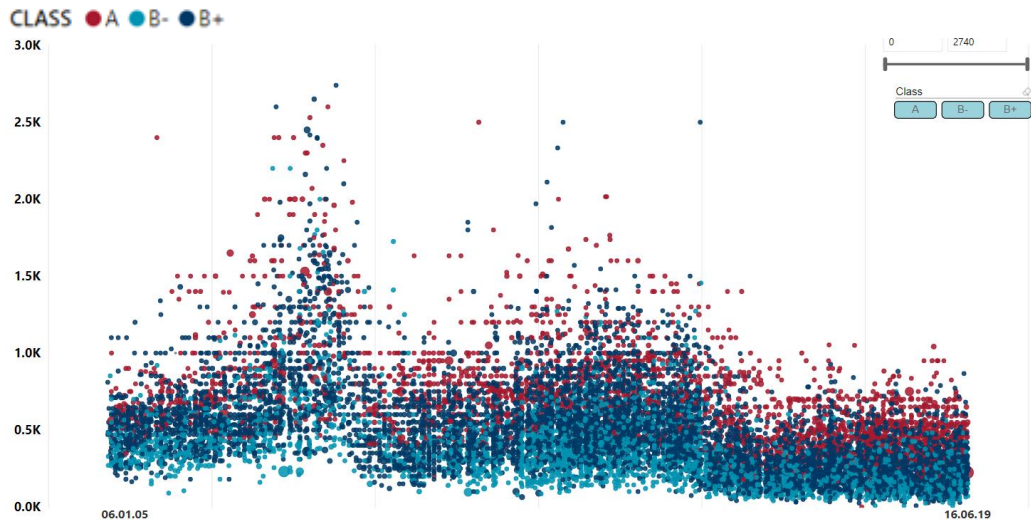


**Absorption** is an indicator that reflects the difference between the area occupied at the beginning and at the end of the period. *Positive absorption* means that additional vacant office premises are "selected" from the market. *Negative absorption* reflects the opposite - the release of additional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

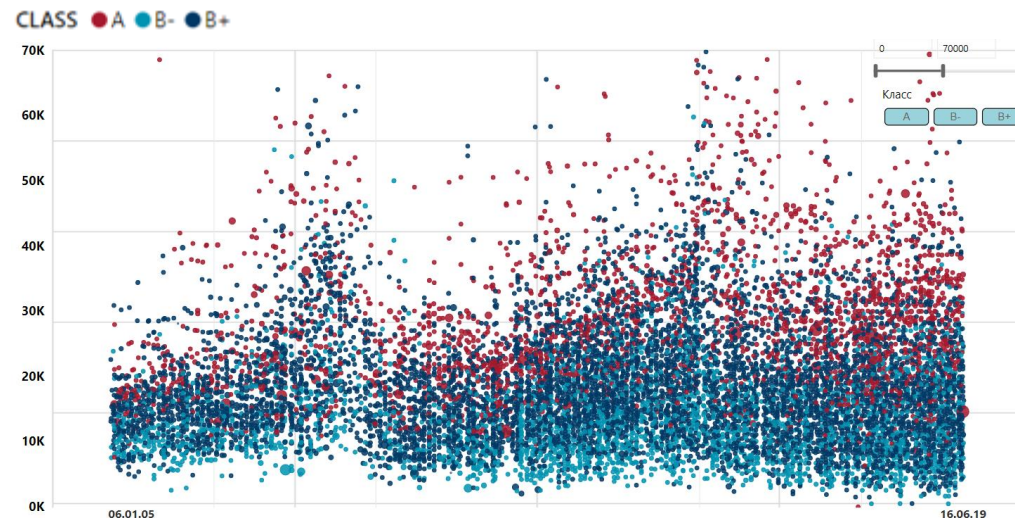
Source: Cushman & Wakefield

# LEASE DEALS IN MOSCOW

## Rental rates in USD equivalent



## Rental rates in RUB equivalent



- The dots on the chart are office lease deals. The horizontal axis represents the date of the deal, and the vertical axis shows the rental rate in USD or Ruble equivalent.
- Using the link or QR code, you can access an interactive graphic that displays the details of each transaction.



## RENTAL RATES

Rental rates continue to grow. Growth was affected by the rise in class B, which began at the end of 2018. However, the growth of rental rate in Class A in H1 2019 was restrained by pre-lease deals, which traditionally close at lower rental rates.

# 304

**USD / sq. m annum**

**July 2019**

US Dollar equivalent (all deals in classes A and B)

# 19,762

**RUB / sq. m annum**

**July 2019**

Ruble equivalent (all deals in classes A and B)

Source: Cushman & Wakefield

### Leasing demand and rental rates, July 2019

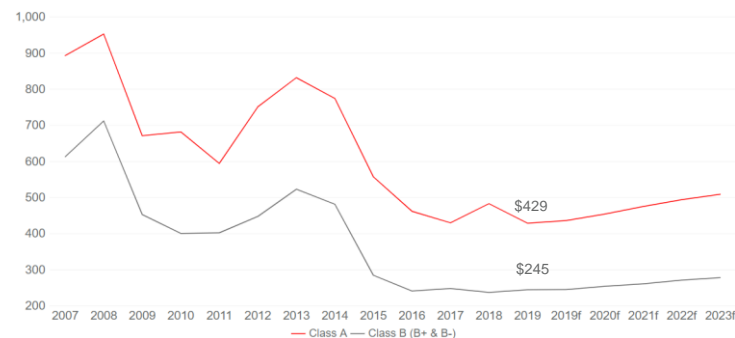
Class	Deal currency	Deals volume, sq. m	Rate
A	USD	67,634	\$569
	RUB	239,096	24,787 RUB
B+ & B-	USD	7,748	\$548
	RUB	642,884	15,680 RUB

Since the beginning of 2019, there is an increase in the average rental rate for high-quality office space. As of July 2019, the increase was 3.5 p.p. relative to the indicator of 2018.

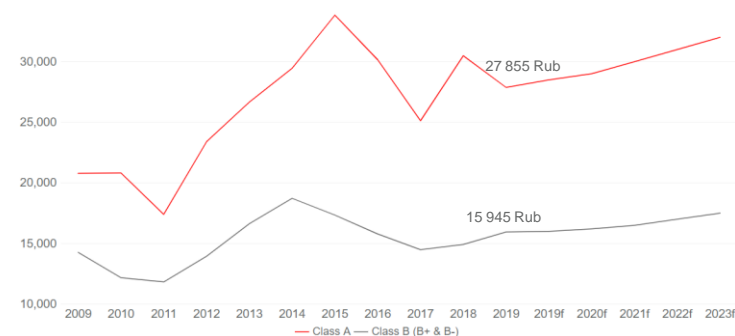
The average US Dollar equivalent of rental rates in Class A (July 2019) is 429 USD/ sq. m/year (27,855 Rubles/ sq. m/year). The average US Dollar equivalent of rental rates in Class B is 15,945 Rubles/ sq. m/year (245 USD/ sq. m/year).

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

### Rental rates in US Dollars



### Rental rates in Russian rubles



## Section 2

# RETAIL

- Consumption growth is restricted by limited financial resources among the population. The decrease in real disposable income is due to the increase in credit load. The financial gap is offset by the use of savings.
- More than 50% of new space to be delivered to the market in 2019 is concentrated in the Moscow area. Next year, construction activity will shift to other regions.
- Despite the opening of a large shopping center, vacancy rate in Moscow is still stable. A slight increase is expected by the end of the year with the launch of two large projects.

## 5.3 mn sq. m

**Total quality stock in Moscow**

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

## 300 '000 sq. m

**New construction, Moscow, 2019F**

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

## 8.2 %

**Vacancy rate**

Quality shopping centers, Moscow

## 170 '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



# POPULATION HAS LIMITED FINANCIAL RESOURCES

Decline in consumer confidence and fall in real incomes due to the rise of loan debt limit retail sales growth. Consumption is at a minimum.

## 1.7%

Retail sales growth

Jan-May 2019 compared to Jan-May 2018

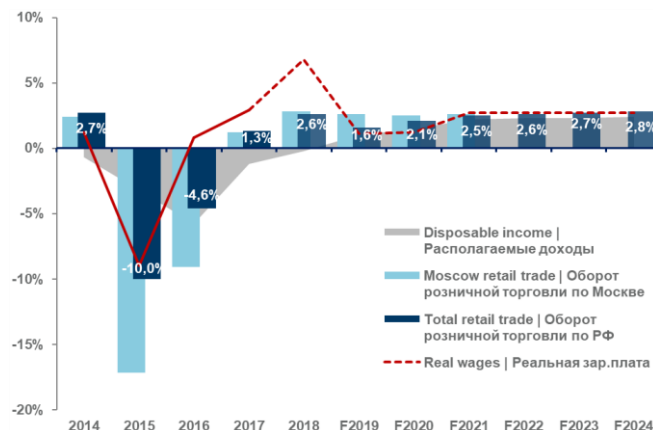
## -2.3%

Real disposable income growth

Jan-May 2019 compared to Jan-May 2018

Source: The Ministry of Economic Development,  
22/04/2019, Rosstat

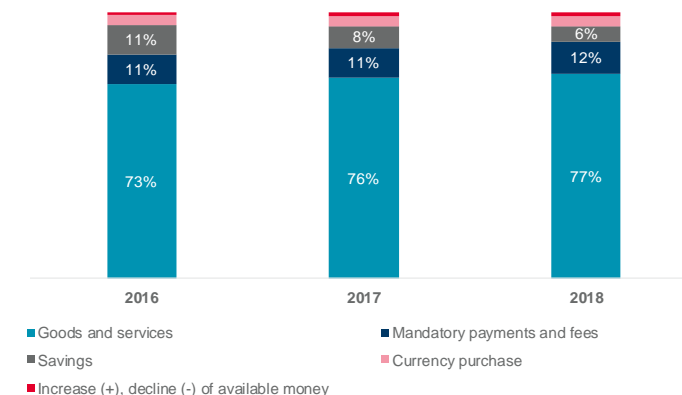
Consumer Market



For the first 5 months of the year, retail turnover revealed dynamics similar to the annual forecast by the Ministry of Economic Development. As expected, the decline in consumer confidence and real disposable income, caused by the growth in credit load, affected the slowdown in consumer spending.

In Moscow, retail sales growth is more modest. In January-May of 2019, the indicator only increased by 0.8%.

Use of income

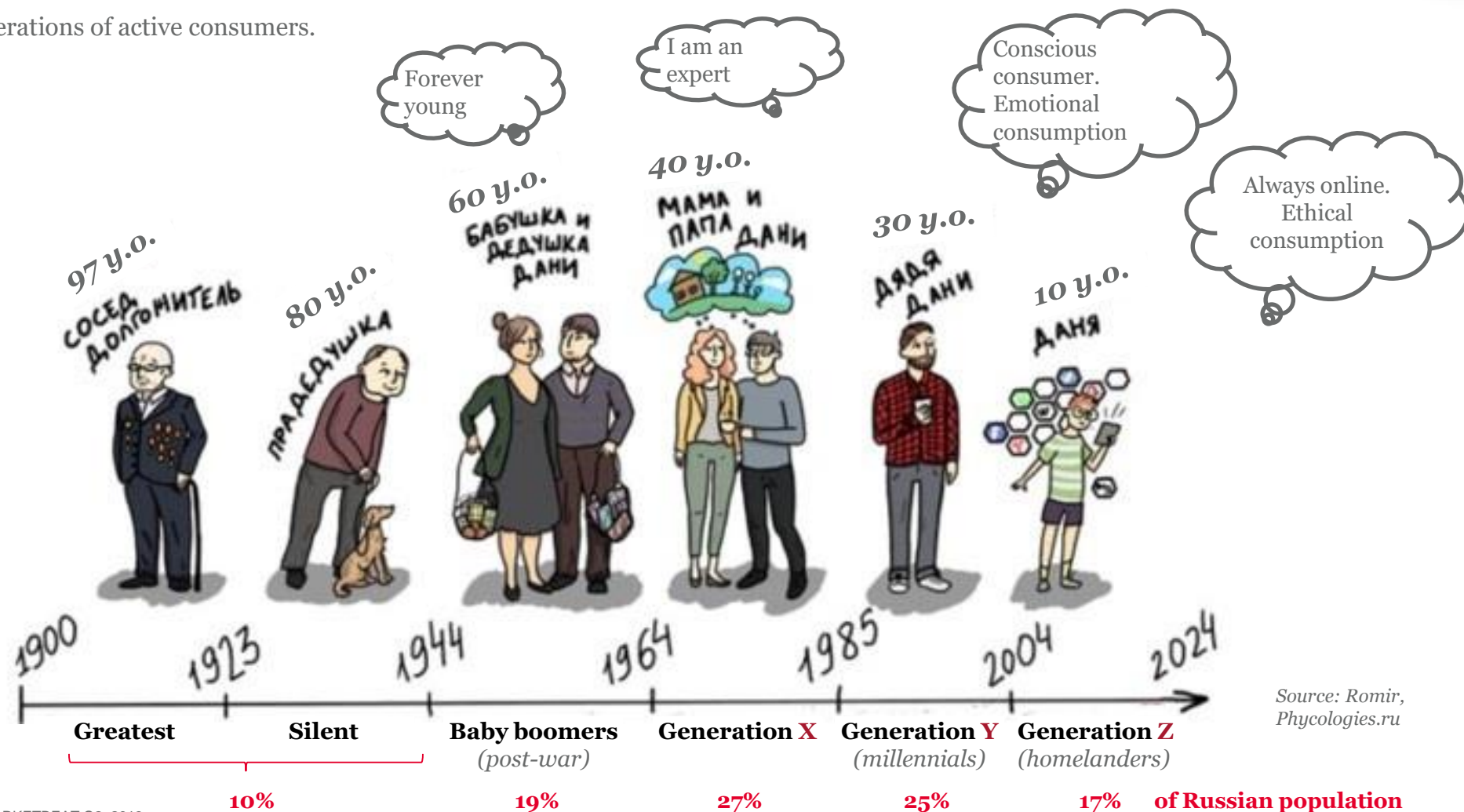


The share of costs on the purchase of goods and services has risen to maximum levels over the past 10 years. The share of mandatory payments, which include the repayment of loans, has increased. This increase was due to a two-fold reduction in the share of savings.

Although the volume of available money has more than doubled, perhaps due to the situation in the banking sector in recent years, the volume remains insignificant.

# GENERATION THEORY – CHANGING CONSUMER

Four generations of active consumers.



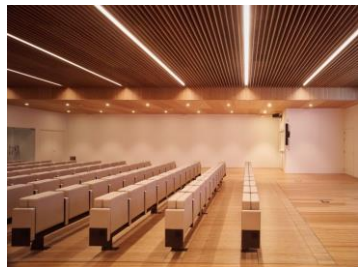
# CONSUMER HABITS

All generations use every trade format with varying frequency. The following are the most popular retail formats among different generations.



# SHOPPING CENTERS OR SOCIAL SPACES?

How will changing trends in retail affect the sale of products? The trade component will likely be reduced, while additional functions will play an increasingly important role.



## Key Trends in Retail:

### Holistic Experience

The customer experience is just as important as the product on sale.

### Ethical Consumption

Now consumers only buy from brands that they believe in.

### Omnichannel

One purchasing format is no longer enough, so sellers are now expected to provide a pleasant purchasing experience across different platforms.

### Changing Loyalty

Companies must now rethink methods to attract loyal customers.

### Augmented Reality

A growing need for new technologies.

*Retail*

# MOSCOW IS THE LEADER OF NEW CONSTRUCTION

Several large retail schemes will be opened in Moscow by the end of the year.



## MODERATE LEVEL OF NEW CONSTRUCTION

Till the end of the year construction activity will continue to concentrate in Moscow as two more large properties are scheduled to open here.

# 196

'000 sq. m

New construction, H1 2019

Russia (including Moscow)

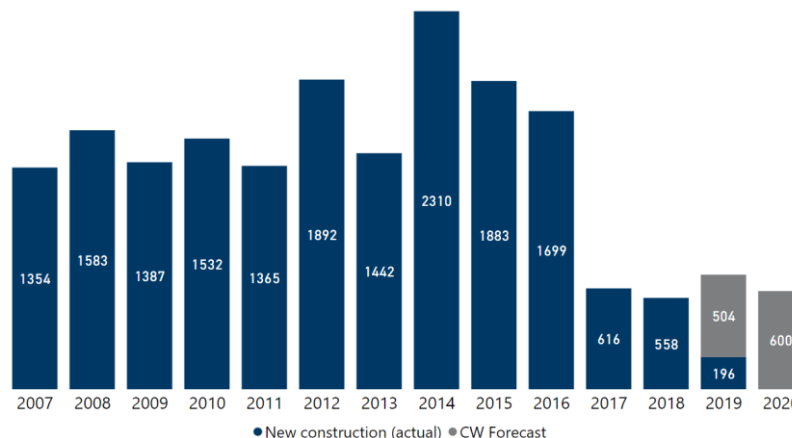
# 700

'000 sq. m

New construction, 2019F

Russia (including Moscow)

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



Source: Cushman & Wakefield

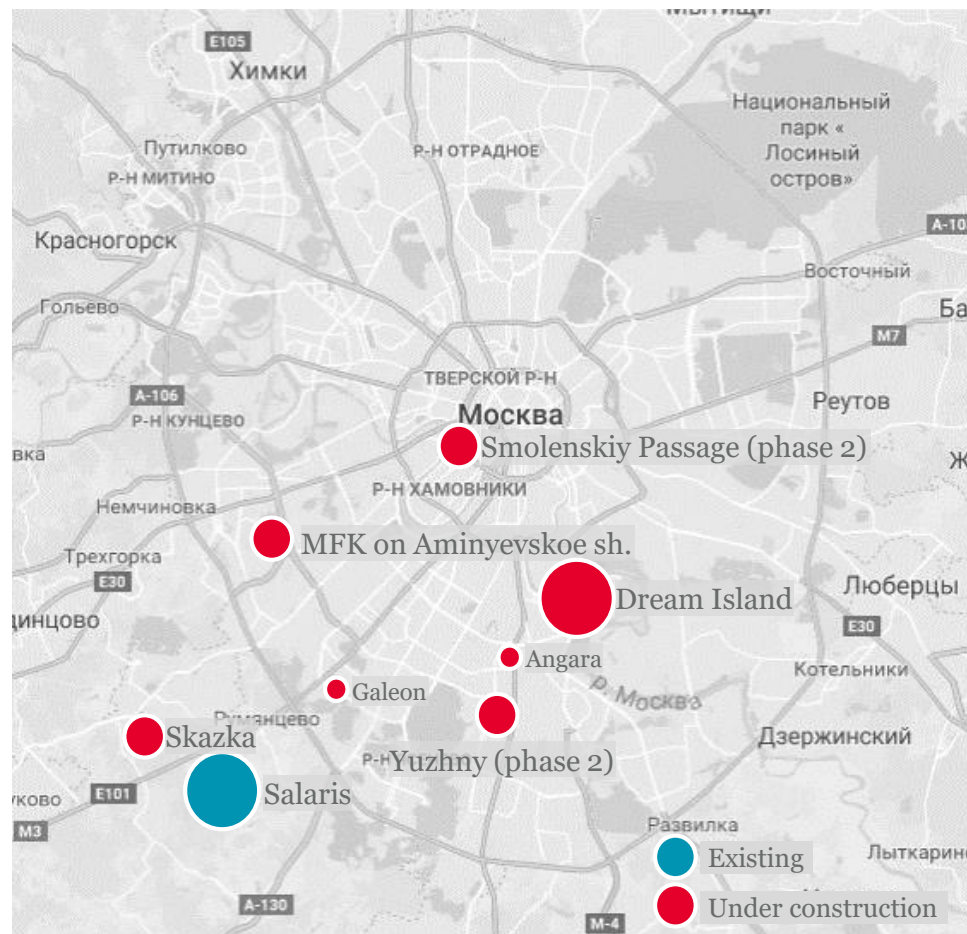
In Q2 2019, no new quality shopping centers were opened in the regions of Russia.

Salaris shopping center (GLA - 105,000 sq. m), the largest opening of 2019, was launched in Moscow in April. Thus, more than half of new retail space in Russia opened in H1 2019 was constructed in Moscow.

According to our forecasts, the volume of new construction in Russia in 2019-2021 will remain at the same level of the past two years. About 500-700,000 sq. m of retail space will be delivered to the market annually.

In contrast to 2019, new projects next year will mainly open in the regions of Russia. Launches of large projects are scheduled in Yekaterinburg, Perm, Grozny, Kirov, among other cities.

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

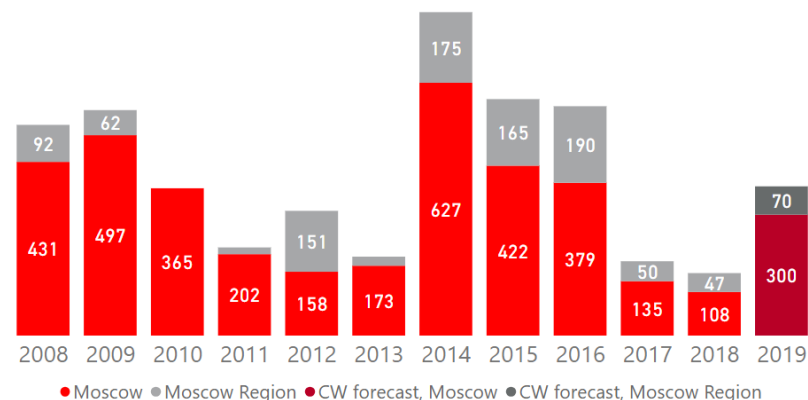


Retail

## NEW CONSTRUCTION IN MOSCOW

Two large projects are planned to open in Moscow throughout the rest of the year.

New construction in Moscow, '000 sq. m



In the Moscow region, the outlet sector is actively developing. By the end of the year, two projects are planned for opening in New Riga, thus the supply of outlets will grow by 50%.

Next year there are no large-scale projects scheduled for delivery to the market in the capital. Small shopping centers and retail schemes within transport hubs will be opening. An increase in the volume of new construction in Moscow can be expected no earlier than 2022.

## MANY FORMATS AND MANY CHANNELS

Time saving and convenience are important criteria for a modern consumer when shopping. Operators are constantly searching and testing new formats and concepts in order to be closer to the consumer.

### NEWCOMERS, H1 2019



Small formats are actively developing: Vkusvill is testing kiosks in parks and micromarkets in offices, Magnit opens a mini-format Magnit City, IKEA opened the first store with an area of 8,000 sq. m within Moscow borders with a full assortment in Aviapark shopping center (the average area of a standard IKEA store is 20-25,000 sq. m).

In order to expand the target audience, retailers collaborate with other market players: Cofix corner opened at Moszkhoztorg store, Azbuka Vkusa started trading at Shell gas stations, and will also sell its ready-to-eat food in the Prisma in St. Petersburg, Sberbank and McDonald's are considering the possibility of launching joint branches, Vkusvill began selling on Wildberries online store.

New international operators continue to enter the Russian market, but at a slower rate compared to previous years.

E-commerce continues to show strong growth. Online players are developing additional delivery channels. Package pickup centers are especially popular: Lamoda will open delivery points in Pyaterochka, Yandex.Market will create a network of BoxBot pickup points which will be installed in Sberbank, shopping centers and Pyaterochka shops, Megafon plans to install pickup points for delivery of goods from various online stores.

Speed has become an increasingly important factor in the delivery of products: McDonald's plans to open dark kitchen restaurants, Yandex launched a pilot project 'Yandex.Lavka' - a grocery store that exclusively operates for delivery, and a network of cloud restaurants (Yandex will deliver ready-made meal kits to partner restaurants, then cooks will prepare the meal and send it for delivery).

## COMMERCIAL TERMS

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

# 170 '000

RUB / sq. m / year

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

# 12-15 %

of turnover

Average rental payment for an operator in retail gallery

Source: Cushman & Wakefield

### Rental rates in prime shopping centers \*

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

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

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

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

## Section 2

# WAREHOUSE AND INDUSTRIAL

- Despite the long-term trend of the vacancy rate decrease and the rise of rental rates in the Moscow region, developers do not show interest in speculative construction.
- In H2 2019, the average asking rental rates may increase to 3900 - 4000 RUB / sq. m / year.

## MOSCOW, CLASS A

	H1 2019	2019 (forecast)
Stock ('000 sq. m)	11,767	12,060
New construction ('000 sq. m)	279	650
Vacancy rate (%)	5.2	4.5
Rental rate * (RUB / sq. m / year)	3,800	3,900
Take up ('000 sq. m)	957	1,300

## REGIONS, CLASS A

	H1 2019	2019 (forecast)
Stock ('000 sq. m)	8,045	8,357
New construction ('000 sq. m)	170	450
Take up ('000 sq. m)	232	450

\* Average rent excluding OPEX, utilities and VAT

Source: Cushman and Wakefield

*Warehouse & Industrial. Moscow region*

# DEVELOPERS DO NOT SHOW INTEREST IN SPECULATIVE CONSTRUCTION

In 2019, the volume of speculative construction is expected to be at the lowest level in the last 5 years.



## SPECULATIVE CONSTRUCTION IS AT FIVE YEAR MINIMUM

In H1 2019, 76,000 sq. m of warehouse space was constructed speculatively – the smallest volume in the last 5 years.

# 279

'000 sq. m

New construction, classes A&B

H1 2019

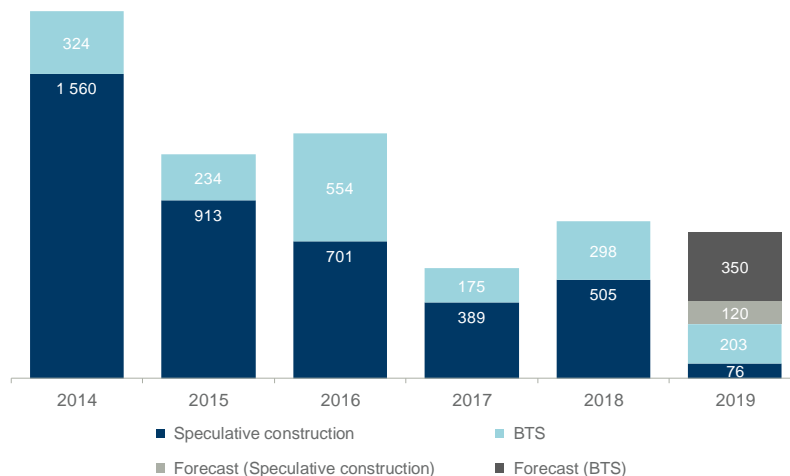
# 27%

Share of speculative construction

H1 2019

Source: Cushman & Wakefield

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



In the Moscow region, the construction volume remains low. In H1 2019, 279,000 sq. m of warehouse space was delivered to the market, which is comparable to the same indicator in H1 2018 (241,000 sq. m).

The largest share of new construction (73%) are built-to-suit projects.

The outlined growth in rental rates and lack of quality space should have increased the interest of developers in speculative construction. However, we still have not seen an increase in activity in this market segment.

At the end of H1 2019, the volume of speculative construction was at its lowest level in the last 5 years. In H2 2019, 120,000 sq. m of warehouse space will be added to the market. Nevertheless, by the end of the year, the total amount of speculative construction will be the lowest over the five-year period.

# VACANCY RATE IS DECREASING

Moscow region: the vacancy rate continues to decline, the average rental rate is growing.

## 5.2%

Vacancy rate, class A

End of H1 2019

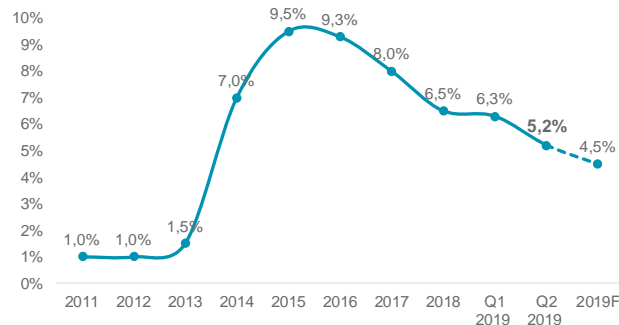
## 3,800

RUB / sq. m / year

Rental rate, class A

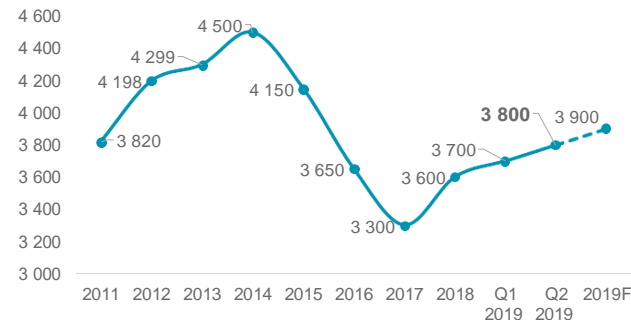
End of H1 2019

Vacancy rate, class A



In Q2 2019, the vacancy rate continued to decline and reached 5.2%. The largest share of vacant space in the first half of 2019 was recorded in the south of the Moscow region – 188,000 sq. m, which is 5% of the total warehouse stock in this area. The lowest vacancy rate was recorded in the north-east of the Moscow region.

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



At the end of H1 2019, the average rental rate for a class A was 3,800 RUB per sq. m per year.

As a result of the continued decline in the vacancy rate, in H2 2019 the average rental rate may exceed the current level and reach 3,900–4,000 RUB per sq. m per year.

Some developers are already raising the asking rental rates in prime locations to this level.

Source: Cushman & Wakefield

\* Average rent excluding OPEX, utilities and VAT

## RETAILERS HAVE THE LARGEST SHARE IN TAKE UP STRUCTURE

Moscow region: retailers accounted for a 43% in the take up in H1 2019.

# 959

'000 sq. m

Take up, class A and B

H1 2019

# 15.9

'000 sq. m

Average deal size (lease and sale)

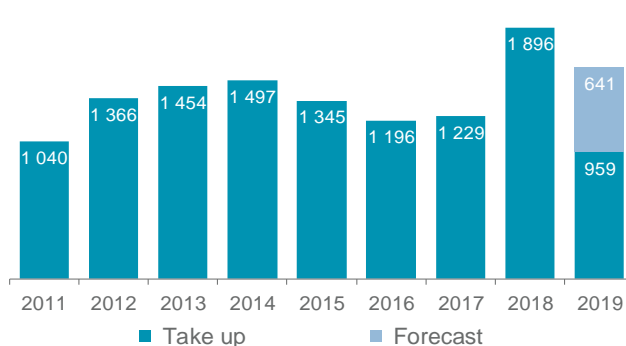
H1 2019

Source: Cushman & Wakefield

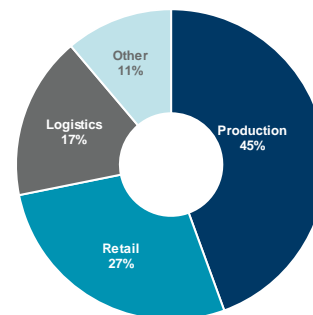
The share of purchase transactions in H1 2019 amounted to 23% of the total take up. The average transaction size was 20,600 sq. m. In the take up structure, manufacturing companies accounted for 45%, and retailers for 27%. The most notable transactions were the purchase of 55,000 sq. m in PNK Park Koledino by the Mistral production company, and the purchase of 28,000 sq. m in PNK Pushkino by Fix Price.

Lease transactions comprised 77% of the total take up. The average size of a lease transaction is 14,900 sq. m. Retailers are the largest players in the leasing of quality warehouse space (48% of transactions). However, it should be noted that this advantage is due to one large lease transaction by Vkusvill at PNK Park Veshki (108,000 sq. m).

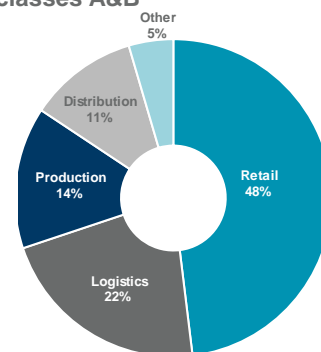
Take up, classes A&B , '000 sq. m



Take up structure (sale), classes A&B



Take up structure (lease), classes A&B



*Warehouse & Industrial. Russian regions*

# **SPECULATIVE CONSTRUCTION FORMS THE LARGEST SHARE OF NEW SUPPLY IN REGIONS**

## IN H2 2019 CONSTRUCTION ACTIVITY IN THE REGIONS IS EXPECTED TO INCREASE

Regions: in H2 2019, the volume of new construction will be almost twice more than in H1 2019.

# 177

'000 sq. m

New construction, classes A&B

H1 2019

# 232

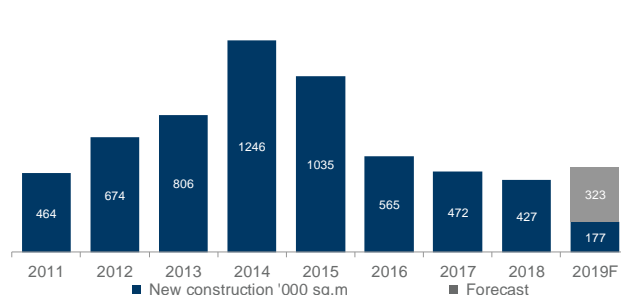
'000 sq. m

Take up, classes A&B

H1 2019

Source: Cushman & Wakefield

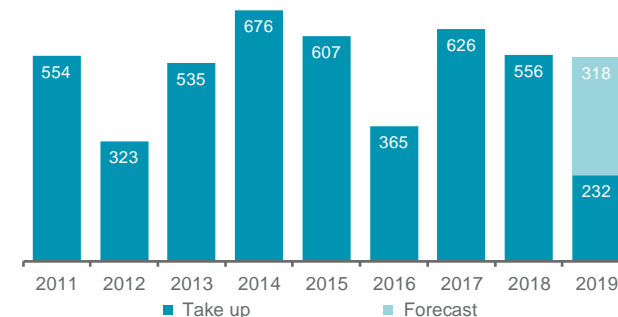
New construction, classes A and B, '000 sq. m



In H1 2019, 177,000 sq. m of warehouse space was delivered to the market, which is 15% below the level in 2018, which amounted to 208,000 sq. m. In contrast to Moscow, the new construction in the regions is formed by speculative construction (67% of total volume).

In H2 2019, construction activity will be mainly provided by individual regions (Ekaterinburg, Rostov-on-Don, Novosibirsk).

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



In H1 2019, 232,000 sq. m of warehouse space were leased and purchased, which is almost 1.5 times higher than in 2018. By the end of 2019, we expect that the volume of transactions will remain at the level of last year.

The main demand in the regions comes from retailers. The largest deals in the first half of 2019 were the purchase by Lenta in Orientir-South in St. Petersburg (69,000 sq. m), and the lease by DNS in Terminal North in Yekaterinburg (17,000 sq. m).

# KEY PROPERTIES AND TRANSACTIONS

Moscow and regions

## Key warehouse properties delivered to the market in H1 2019

Property	Region	Total area
<b>Moscow region</b>		
Vnukovo II	Moscow	92 953 sq. m
IKEA Esipovo	Moscow	90 000 sq. m
Wildberries DC	Moscow	48 900 sq. m
VS-Svitino	Moscow	27 775 sq. m
<b>Regions</b>		
SK Sibirsky	Novosibirsk	40 000 sq. m
Osinovaya Roscha	St. Petersburg	38 000 sq. m
Logopark M10	St. Petersburg	28 000 sq. m
TLK Severny	Ekaterinburg	24 500 sq. m

## Key warehouse deals of H1 2019

Tenant/Buyer	Property	Region	Deal type	Total area
<b>Moscow region</b>				
VkusVill	PNK Park Veshki	Moscow	Lease	108 000 sq. m
Mistral	PNK Park Koledino	Moscow	Sale	55 500 sq. m
Pochta Rossii	Vnukovo II	Moscow	BTS	50 250 sq. m
Yandex.Market	Sofyino	Moscow	Lease	35 000 sq. m
<b>Regions</b>				
Lenta	Orientir -South	St. Petersburg	BTS	69 100 sq. m
Lorenz Snack-World	Kirishi	St. Petersburg	BTS	18 650 sq. m
DNS	Severny Terminal	Ekaterinburg	Lease	16 930 sq. m



## Section 2

# HOSPITALITY

- Despite worst expectations of hoteliers, over the five months of 2019 hotel demand regained usual volumes.
- No new modern quality rooms were added in Q2 2019.
- With minimal fluctuations of main trading indicators (2.5 p.p. increase in Occ counterweighted by a 4.0% decrease in ADR, resulting in a 0.5% “growth” of RevPAR), YTD May operating results remained lukewarm.

## 60.5K keys

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

The City of Moscow's and Cushman & Wakefield's estimates, Q2 2019

## 20.2K keys

**Modern quality room stock**

Cushman & Wakefield's estimates, Q2 2019

## 0 keys

**In new hotels in Moscow**

Net room stock increase in Q2 2019

## 0 keys

**In new hotel projects**

Net room stock expected in Q3-4, 2019

# MINIMAL GROWTH OF THE MARKET IN 2019

440 rooms planned to open in 2019 are shifted to 2020.

## 0 keys

### Supply increase in Q2 2019

In new hotel projects

#### New supply in Moscow in 2019

Hotel project	Keys	Opening
Holiday Inn Express Baumanskaya	128	Q1
<b>Total</b>	<b>128</b>	

*Source: Cushman & Wakefield*

# NEXT BIG GROWTH IN SUPPLY – NOT BEFORE 2021

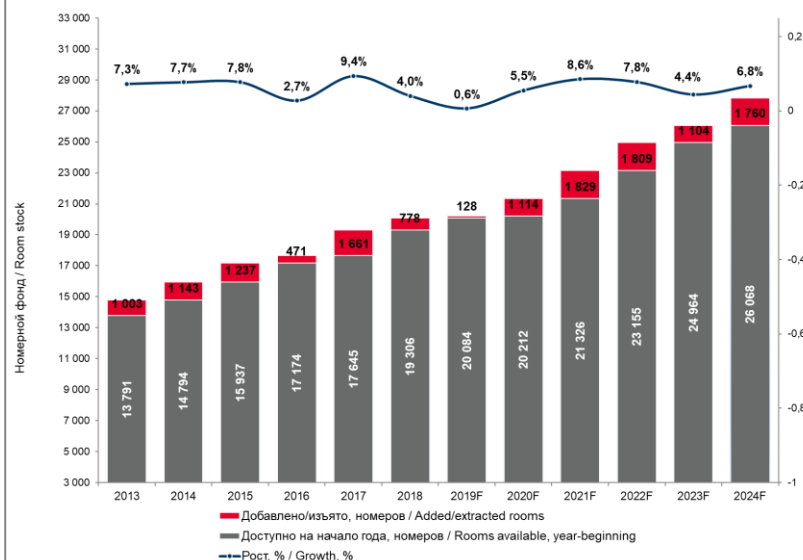
The increase of new room stock is limited to 128 keys in 2019.

## 0.6%

Year-on-year growth in 2019

Expected market growth in 2019

Supply growth dynamics – actual and projected



Compared to a 4-percent increase of the market pie registered in 2018, 2019 is likely to see very little growth. The original forecast of 3.6% made by Cushman & Wakefield in Q1 is reviewed as the indicator is expected to remain below 1%.

In the absence of noticeable improvements to the health of the national economy, hotel developers continue to push construction launches further and further down the road. As a result, the Moscow market's average annual growth rate in 2020-2024 is generally expected to remain at very average 6.6% per annum.

Source: Cushman & Wakefield

# JAN-MAY TRADING RESULTS – STILL UNIMPRESSIVE

Moscow hotels regained occupancies but not rates.

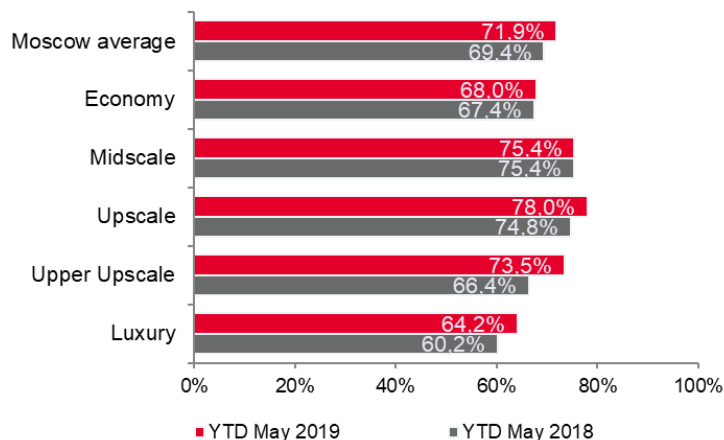
## 2.5 ppt

Change in Occ  
Jan- May 2019  
Wider market

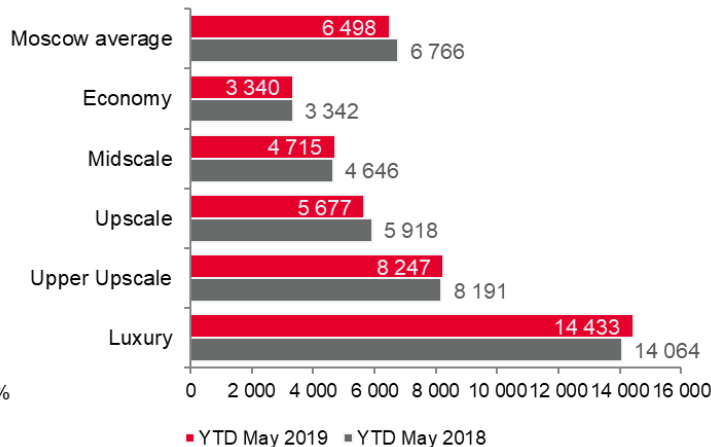
## -4.0 %

Change in ADR (RUB)  
Jan- May 2019  
Wider market

Occ, Jan-May 2019, by segment



ADR (RUB), Jan- May 2019, by segment



Even though Wider market's Occ added only 2.5 percentage points over the same period in 2018, it was registered in all categories of hotels. Having said that, while Midscale hotels demonstrated a nominal Occ increase of 0.1 p.p., Upper-Upscale properties saw their Occ levels jump whopping 7.1 p.p.

ADR levels, however, showed a higher variability of results – from small-size growth levels in Luxury, Midscale, and Upper-Upscale segments (2.6%, 1.5%, and 0.7%, respectively) to a subtle negative correction in the Economy properties (-0.1%). Upscale hotels performed the worst, having lost 4.1% of their 2018 ADR levels. As a result, the Wider market's ADR indicator saw a 4.0-percent decline year-on-year.

Source: Cushman & Wakefield

# ROOM YIELD CHANGE – BARELY NOTICEABLE

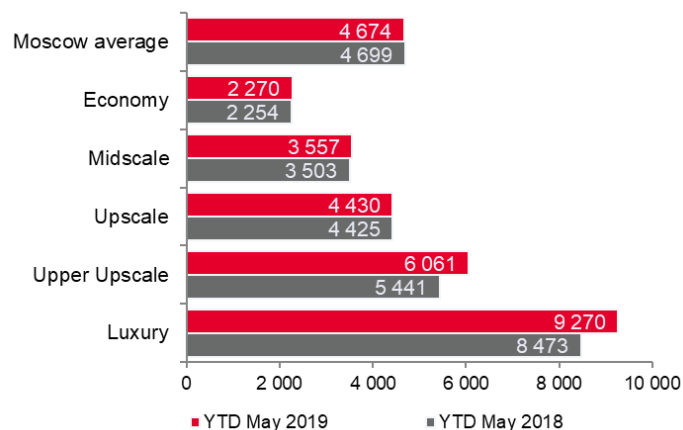
## -0.5 %

Change in RevPAR (RUB)  
Jan- May 2019  
Wider market

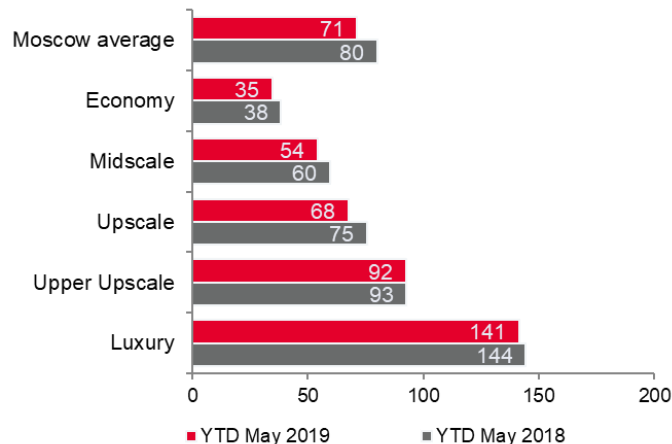
## -10.9 %

Change in RevPAR (USD)  
Jan- May 2019  
Wider market

RevPAR (RUB), Jan- May 2019, by segment



RevPAR (USD), Jan- May 2019, by segment



While Wider market's RUB-denominated RevPAR change over the 5 months of 2019 stayed within the margin of error (-0.5%), Upper-Upscale and Luxury hotels showed more impressive results (11.4% and 9.4%, respectively).

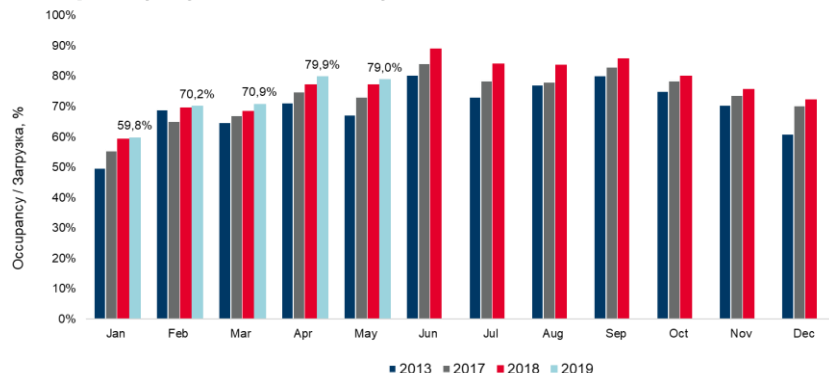
Calculated in US Dollars, however, RevPAR dynamics has a more negative view. This is explained by the unstable exchange rate of the national currency, which in 2018 lost 20% of its value before regaining 5.1% of it back over the first four months of 2019.

Source: Cushman & Wakefield

# BACK TO BASICS

What can Moscow hotels reasonably expect in 2019?

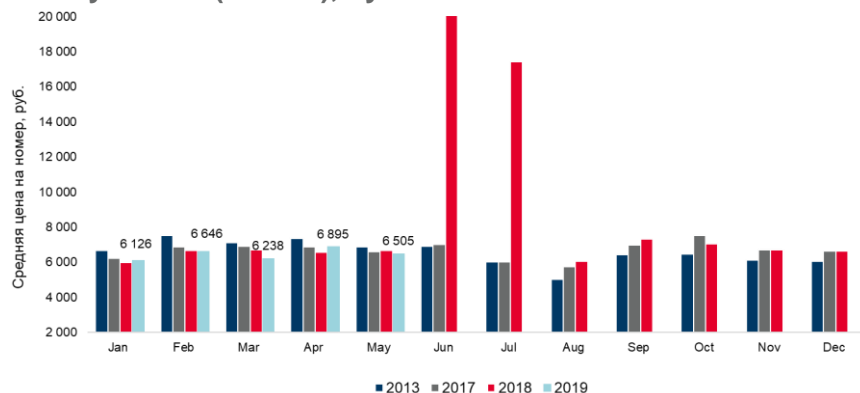
## Occupancy dynamics, %, by month



The slow start of the year, typical for the Moscow market, ended with better than expected results – compared both to the same periods in 2017-2018, as well as the 'benchmark' year of 2013.

However, the graph below shows that the ADR levels in nominal terms have not grown since 2013. This stagnation of the rates cannot be explained solely by the recent supply growth (nearly 2,500 keys added over 2017-2018, of which 60% are Midscale or below). Instead, it is likely the health of the national economy which is not creating enough demand for the Moscow hotel infrastructure.

## ADR dynamics (in RUB), by month





# STANDARD COMMERCIAL TERMS

## LEASE TERMS

### DURATION OF LEASE

**Offices:** 3-7 years

**Industrial:** either short-term (1-3 years) or long-term (5+ years)

**Retail:** 3-5 years, anchor tenants - 7-10 years.

### BREAK OPTION

**Offices:** Possible after 3 years with penalty. After crisis became very popular. Notice period is 6-12 months. Contract can be terminated from both sides.

**Retail:** Possible after 2-3 years, subject to negotiation with landlord.

## DISPOSAL OF LEASES

### ASSIGNMENT AND SUB-LETTING

**Offices & Industrial:** Usually possible, but subject to negotiation.

**Retail:** Not common, in some cases subject to negotiation.

## FEES

Agent service fees:

**Offices:** depends on the type of service and type of deal, **Retail:** 8-12% of the annual lease payment, **W&I:** lease - 1-2 months of lease payment, acquisition – 2-3%.

**Land:** acquisition- 3-5% depending on the land plot size.

## MEASUREMENT PRACTICE

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

## RENTAL PAYMENTS

### RENT PAYMENT AND FREQUENCY

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

**Industrial:** Rubles.

### RENT DEPOSIT

**Offices:** 3 months rent equivalent (bank guarantee optional, very seldom as landlords prefer the deposit).

**Retail:** 1-2 months rent equivalent (bank guarantee optional).

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

### RENT REVIEWS

After crisis have become more popular, negotiable.

### INDEXATION

**Offices:** at the level of Russian CPI or 4-7% for RUB agreements; 2.5-4% or at the level of USA / EU CPI for agreements in foreign currency.

**Retail:** 5-10% or CPI in Russia for RUB agreements, 2-5% or US CPI for agreements in USD.

**Industrial:** 4-8% (for agreements longer than 5 years not more than 5-6%).

### TURNOVER RENTS (only in Retail):

Compound rental rates (minimum fixed rent + a percentage of turnover) are almost always used in shopping centers. Normally, the percentage of turnover varies between 12-15% for fashion, 1-3% for anchor tenants.

## SERVICE CHARGES, REPAIR AND INSURANCE

### REPAIR

**Tenant:** Internal repairs and maintenance.

**Landlord:** Structural repairs, common areas.

### INSURANCE

**Tenant:** Contents insurance.

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

### SERVICE CHARGES

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

### UTILITY EXPENSES

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

**Retail:** in some cases, service expenses can be increased due to the regular growth of utility expenses after provision of supporting documents.

**Industrial:** usually paid separately on the basis of actual consumption.

## TAXATION

### REAL ESTATE TAX

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

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

VAT: 20% (from January, 1 2019)

# #MARKETBEAT

Section 3

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[www.cwrussia.ru](http://www.cwrussia.ru)

About the company

## **CUSHMAN & WAKEFIELD IN RUSSIA**

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



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