



REAL ESTATE MONITOR

Magazine of the Association of European Businesses

CAPITAL · OFFICE · RETAIL · WAREHOUSE · HOSPITALITY · HOUSING



Decathlon required the most advanced fire suppression system available in Russia. We took on their high standards as a challenge.

David Simons
Managing Director, Radius Group

Our project monitor, who has 20 years of experience in Russia, told me he's never seen such a high level of construction quality before. It's perfect for Decathlon.

Gaetan Boursaux
Expansion Manager for Russia

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Decathlon's insurer called for a fire protection system meeting NFPA13 standards. We installed a best-in-class **ESFR25** (Early Suppression, Fast Response) system. The sprinklers overhead are fed by a unique pumphouse incorporating a three-pump system – a main pump as well as two additional back up pumps, one of which is powered by a dedicated diesel engine. This system is in turn fed by South Gate's own pumphouse with an identical three-pump set-up, ensuring uninterrupted water supply for the fire safety systems. At Radius Group, details matter.



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**Frank Schauff**

Chief Executive Officer,
Association of European
Businesses

Dear reader,

I am glad to welcome you to the first edition of the AEB Real Estate Monitor for the year 2015!

It is no secret that there have been significant changes in the economy as a whole as well as in particular parts of it – the real estate segment is an example. 2014 saw significant exchange-rate fluctuations that dragged the real estate market down into crisis by making people hang on to their savings. Especially problematic has been the stock market where many people have been trying to liquidate their investments at any price as the exchange rate has changed. Several construction companies raised credit in foreign currencies before the situation changed so dramatically. Now their obligations have increased due to the currency fluctuations, leaving them short of cash to service their recently inflated debt.

As the disposable income of the population has been reduced by these events, housing rents are unlikely to rise, if the prices go up – the rent may become a weak blank space of the market where supply is already exceeding demand.

Many experts agree that developers will try to raise prices per square metre, hoping to peg their income to their foreign currency-denominated debt obligations in order to avoid a negative cash-flow. Given the overall market weakness it is thought they are unlikely to be successful. Let us hope these predictions do not come true.

I would like to take this opportunity to thank those of our Real Estate Committee members who have been active in contributing to this publication and to the other activities of the Committee.

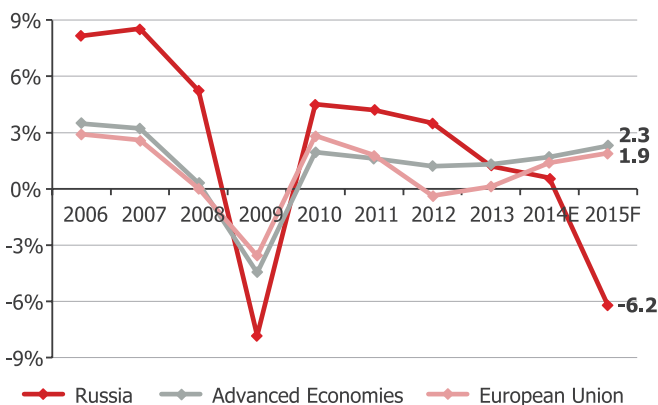
It is my hope that you will find this publication a useful resource, and that it will help you grow your business. I look forward to seeing many of you at our upcoming Real Estate Committee events.

Moscow market overview

Capital market

2014 was truly challenging for the Russian market, 2015 will be even tougher. A plunging oil price, conflict in Ukraine, sanctions, counter sanctions and a tumbling rouble have heaped pressure on an economy that was already experiencing a cyclical slowdown. Consensus GDP forecasts have been significantly revised down. According to estimations of the Ministry of Economic Development, GDP growth is expected at 0.6% in 2014. According to Oxford Economics, GDP for this year will fall by 6.2% having been revised down from their previous forecast of 0.0% growth. (1 ▶)

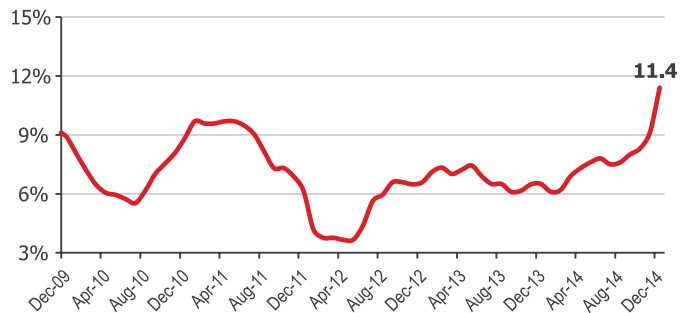
1 ▶ RUSSIA GDP GROWTH, % YOY



Source: Oxford Economics

Monetary policy will remain tight in 2015. The Central Bank raised its policy rate to 17% after the rouble crashed in mid-December and cut it to 15% in the end of January. We do expect a less hawkish stance in H1 2015, though rates will remain at historically high levels and will be a limiting factor for domestic demand this year. (2 ▶)

2 ▶ RUSSIAN CPI*, % GROWTH, YOY

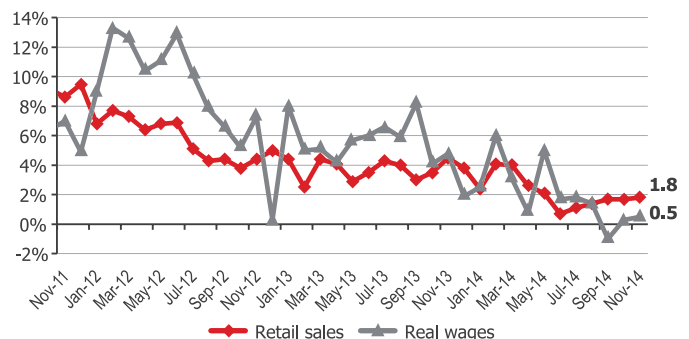


* consumer price index

Source: Oxford Economics

In the final quarter of last year, retail sales have been supported both by the holiday season and expectations of further rouble weakness. In our view, the strength in durable goods purchases is unsustainable and will fade as we move into 2015, and as retailers adjust prices in line with both inflation and the higher cost of imports. Combined with falling real wage growth, due largely to freezes in public sector pay, retailers, in particular, are facing a difficult 2015. (3 ▶)

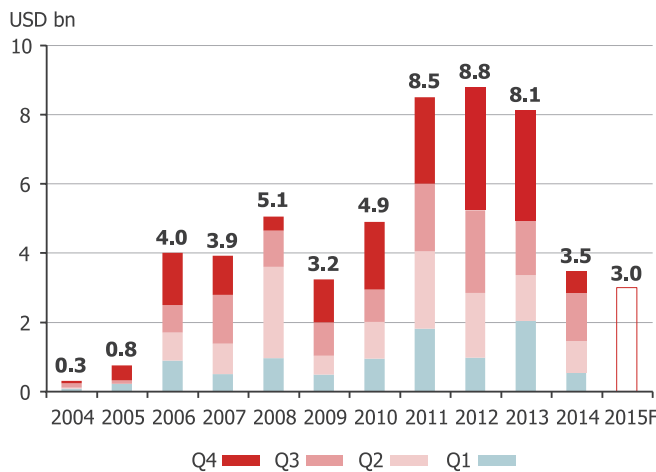
3 ▶ RETAIL SALES VERSUS REAL WAGES, % GROWTH, YOY



Source: Oxford Economics

We expect real estate investment at about \$3 bn in 2015, down 14% compared to 2014. Similar to 2008–2009, we see mismatch between buyers’ and sellers’ expectations which will be a constraint for real estate investment deals. In the situation where the capital value declined from the recent high levels, owners are not ready to sell. Since the commercial real estate cycle requires a good understanding of future prospects, potential buyers need stability, and are unwilling to take on risk by buying in such a volatile market. (4 ▶)

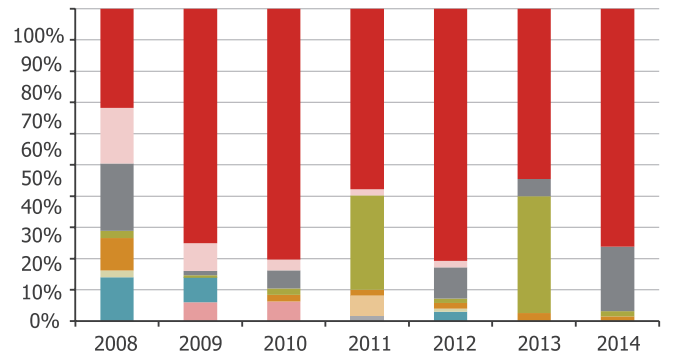
4 ▶ INVESTMENT VOLUMES DYNAMICS, RUSSIA



Source: JLL

In 2014 local investors are increasingly dominating the market with Russian players accounting for 76% of deals in 2014 compared to 55% in 2013. We expect this dynamic to continue in 2015 as local players tend to be more active during times of economic uncertainty. Nevertheless, foreign investors will probably have a lower cost of debt financing, and during the coming months the Russian market could offer good investment opportunities to companies with strategic vision and risk appetite. Among new investors in the Russian market could be representatives from Asia and the Middle East, for example, from China, UAE, and Qatar. (5 ▶)

5 ▶ INVESTMENT SOURCE BY ORIGIN

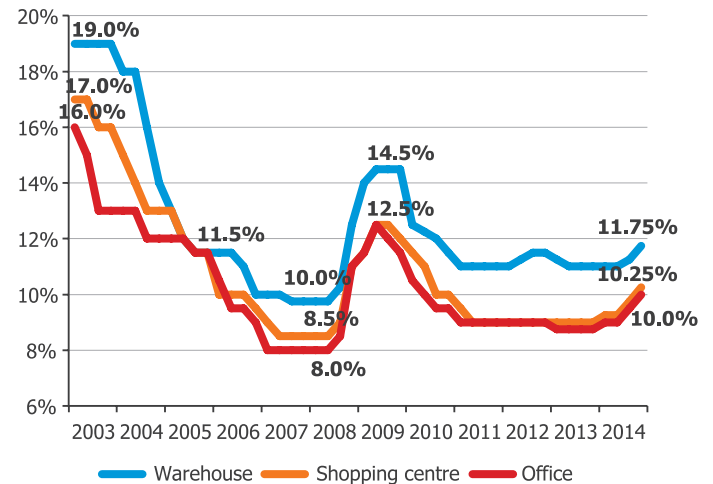


Legend: China, UK, Canada, USA, Kazakhstan, Finland, Global, Other, Confidential, Russia

Source: JLL

Prime yields have also reacted to the current market situation. In Q4 prime yields in Moscow for assets with operating income and debt in place both nominated in foreign currency increased by 50 bps, to 10.0% for offices, 10.25% for shopping centres, and 11.75% for warehouses. (6 ▶)

6 ▶ PRIME YIELD DYNAMICS, RUSSIA



Source: JLL

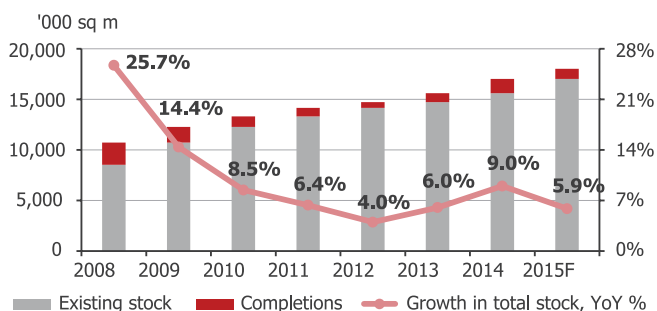
Office market

According to JLL analysts, the amount of new supply of high quality office space in 2014 totaled to 1.4 mln sq m, which was 58% higher than 2013, setting the highest level of completions in five years. Moreover, the amount of new deliveries in Class A was 713,128 sq m which is a record high.

As for quarterly dynamics, the volume of new supply in Q4 amounted to 370,390 sq m which was 22% higher YoY. Over the past three months about 15 buildings entered the Moscow office market, including OKO MFC (110,000 sq m – office area), Port Plaza (62,700 sq m) and Orbita (Phase II: 39,400 sq m).

As a result, by the end of December the total supply of high quality office space in Moscow reached 17 mln sq m showing a 9% growth on a YoY basis. (7 ▶)

7 ▶ THE DYNAMICS OF COMPLETIONS OF NEW OFFICE SPACE IN MOSCOW

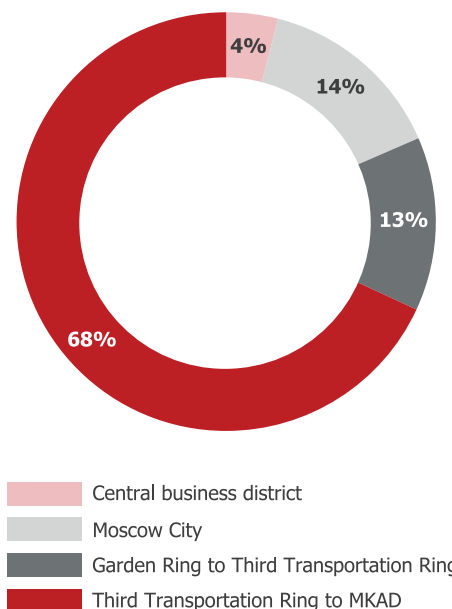


Source: JLL

The majority of deliveries in Q4 were Class B+ premises (56%), while the share of Class A office space comprised about 41% of new supply. For the whole of 2014, new deliveries were almost equally distributed between Class A and Class B+ while Class B- buildings comprised only 4% of the total amount of new supply.

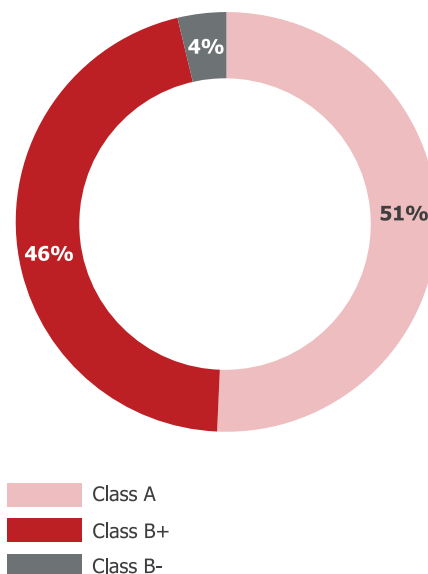
The largest share of new supply in 2014 was located outside the Third Transportation Ring (TTR) while only 4% of new office space was delivered in the Central Business District. Moscow City area accounted for 15% of total 2014 deliveries of high quality office space due to the commissioning of such objects as Steel Peak Tower (former Eurasia Tower; 94,000 sq m – office area) and OKO MFC. (8, 9 ▶)

8 ▶ 2014 MOSCOW OFFICE COMPLETIONS BY LOCATION



Source: JLL

9 ▶ 2014 MOSCOW OFFICE COMPLETIONS BY CLASS

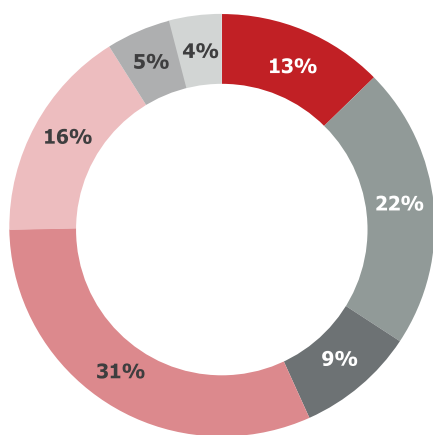


Source: JLL

Through 2014 the demand for office space remained hostage to the economy. In terms of dynamics of demand for office space, the volumes of take-up in 2014 were estimated at 1.1 mln sq m which was a 24% lower YoY and turned out to be the lowest amount of annual take-up volumes seen in the past five years. The structure of demand has noticeably changed with the share of renewals and renegotiations comprising 40% of the total amount of deals in 2014 from 20% seen in 2013. The largest transaction recorded over the past year was the lease of 17,370 sq m office space by Systematika Group of Companies in ComCity Phase I Alfa.

Sector-wise, Manufacturing companies accounted for 31% of all recorded transactions, while companies from the Service Industry sector had a 22% share. The total volume of transacted office space over the 2014 was equally distributed between foreign and domestic tenants. (10, 11 ▶)

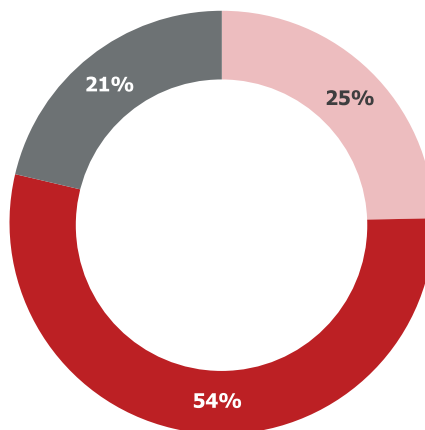
10 ▶ 2014 MOSCOW OFFICE DEMAND BY BUSINESS SECTORS



- Banking & Finance
- Business Services
- Construction, Mining & Exploration
- Manufacturing
- Service Industries
- Wholesale & Retail
- Other

Source: JLL

11 ▶ 2014 MOSCOW OFFICE DEMAND BY CLASS

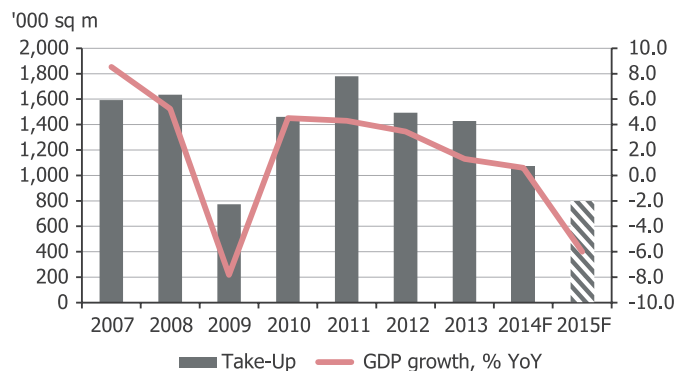


- Class A
- Class B+
- Class B-

Source: JLL

Changes in the macro environment, such as the expected fall in GDP and the persistent high volatility of the rouble, will be the main factors affecting demand for office space this year. According to JLL analysts, with the expected 4–6% fall in GDP in 2015 the volumes of take-up are estimated to be close to 700–800 thousands sq m (a 25–30% YoY decrease) which is comparable to the levels seen in 2009. (12 ▶)

12 ▶ MOSCOW OFFICE TAKE-UP AND GDP LONG-TERM RELATION



Source: JLL

By the end of December, the overall vacancy rate of Moscow office market stood at 16.6% compared to 13.7% level seen in 2013. As a result of the high level of completions of high quality office premises in 2014, the vacancy rate in Class A reached 28.4% while in 2013 only 18.2% of all Class A office space was empty. Class B+ vacancy rate ticked up to 15.5% vs 13% seen in 2013.

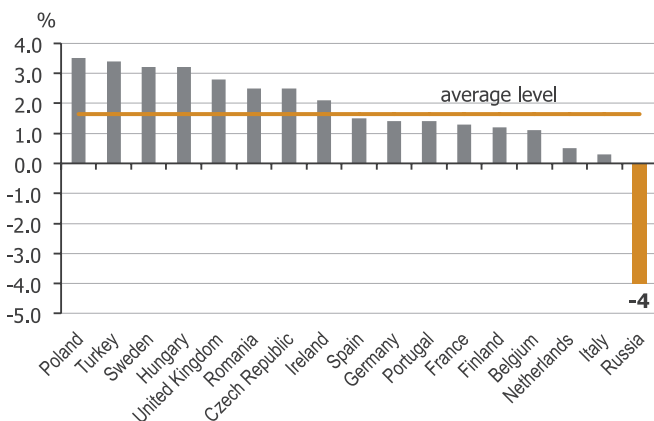
The rental cost decreased on average by 22% YoY in 2014 with the prime rents in the range of \$750–900 per sq m per year. Class A rents ranged between \$450 and \$650 and Class B+ between \$275–450 per sq m per year. In Moscow City area, rents ranged between \$450–650 per sq m per year.

Retail market

The past year can be characterized mainly by falling oil prices, dramatic rouble devaluation, and a broad slowdown in Russia’s economy. The retail market is of course significantly affected by the current environment. Retailers have strong pressure on revenues, which has led to many of them re-viewing their development plans and a few have even left Russia. The construction and commissioning of new shopping centres are also under pressure. The combination of retailers’ moderating demand and lack of financing will force developers to postpone the launch of the newly planned projects. Nevertheless, they are likely to finish those ones that are at an advanced stage. (13 ▶)

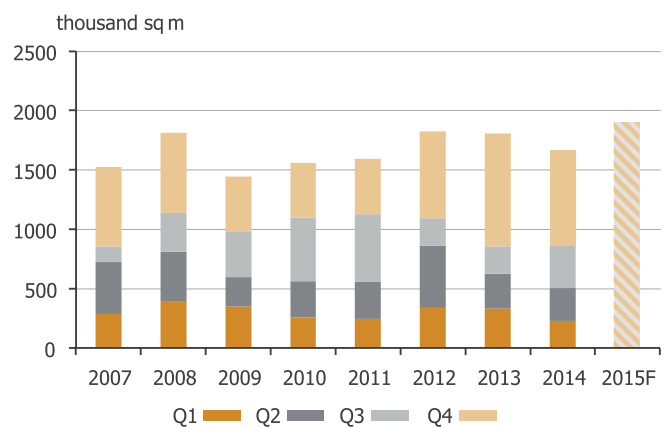
The completion of retail space in Russia in 2014 equal to 1.63 mln sq m, down 10% YoY. The majority of new premises are in Moscow, which is more than 35% of the total figure. This is the highest annual completion level ever seen on the capital’s retail market (602,600 sq m). The majority of new shopping centres were opened in Q4 (317,500 sq m). (14 ▶)

13 ▶ RETAIL SALES FORECAST, RUSSIA, % YOY GROWTH



Source: JLL

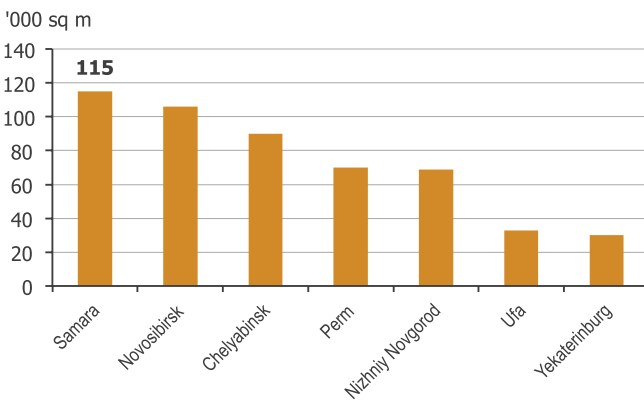
14 ▶ COMPLETION DYNAMICS IN RUSSIA



Source: JLL

In fact, the pipeline announced by the developers accounted for more than 2.6 mln sq m, though we believe many projects are likely to be put on hold. As a result we expect not more than 1.9 mln sq m are likely to be delivered, still this result may become record high for the Russian retail market. (15 ▶)

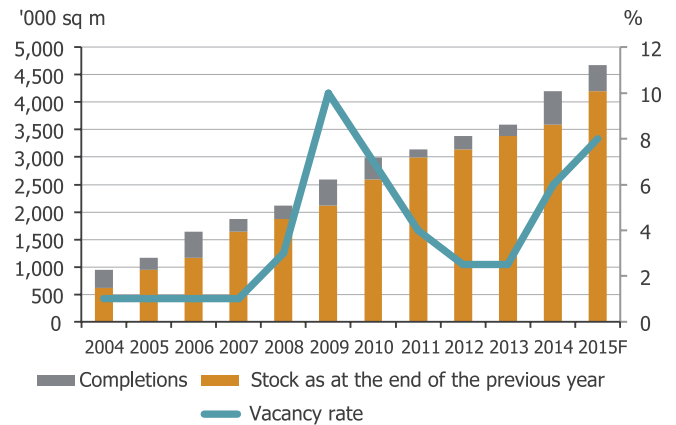
15 ▶ THE VOLUME OF EXPECTED SUPPLY IN RETAIL SPACE IN 2015 IN THE CITIES WITH A POPULATION OVER 1 MLN



Source: JLL

Due to the current economic climate in Russia, the extraordinary level of completion and the pressure of limited demand, the overall SC vacancy rate had risen to 6% by the end of 2014. As real personal incomes and retail sales are expected to continue declining, many operators are downgrading their development plans in 2015. Some of them will close unprofitable stores, whereas a few market players will terminate their activity on the market. Taking this into account, and given such a large pipeline, we expect the overall vacancy rate to reach 8% by the end of 2015. (16 ▶)

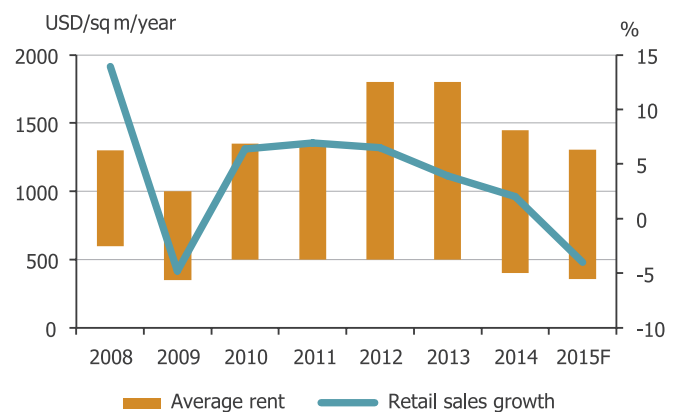
16 ▶ MARKET BALANCE



Source: JLL

The average rental level has decreased by 20% in Q4. Retailers are continuing to insist on a short term turnover rent or rental discount, fixing foreign currency exchange rate band. On the back of increasing competitiveness between shopping centres and the retailer demand decline, the rents are likely to further come down in 2015. Nevertheless, the most successful SCs should remain in demand and in this case prime rents are not expected to shrink significantly. (17 ▶)

17 ▶ AVERAGE RENT DYNAMICS, MOSCOW



Source: JLL

Warehouse and Industrial

NEW SUPPLY MOSCOW 2014 1,670,000 sq m
 VACANCY RATE FOR CLASS A 7%

OUTLOOK

From the beginning of 2014, the warehouse real estate market in **the Moscow region** has become more favorable for tenants. In H1 2014, the supply of quality warehouses increased significantly, which resulted in growth of vacancies. For the first time since 2011, the tenants

have been finally able to choose not only warehouses under construction, but also existing warehouses. Since spring 2014, unstable and unpredictable situation in Russia has weakened tenant activity. However, the demand for warehouse space remains high, but the tenants tend to postpone long-term lease or purchase decisions. Excess supply, pent-up demand together with unstable economic situation have led to the necessity of searching for the commercial policy options in the short, medium and long terms for all quality warehouse market players in H2 2014.



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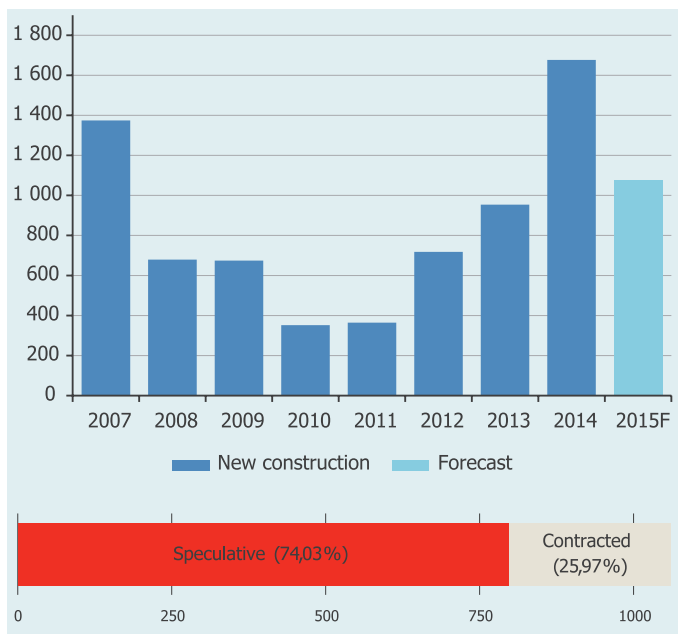
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In the Regions, economic and political factors did not affect the market as much. During 2014, demand was persistently high. (18 ▶)

18 ▶ NEW CONSTRUCTION OF WAREHOUSE PROPERTY IN THE MOSCOW REGION ('000 SQ M)



Source: Cushman & Wakefield

TRENDS

According to our projections, in 2015, the following factors will influence warehouse market in the Moscow Region.

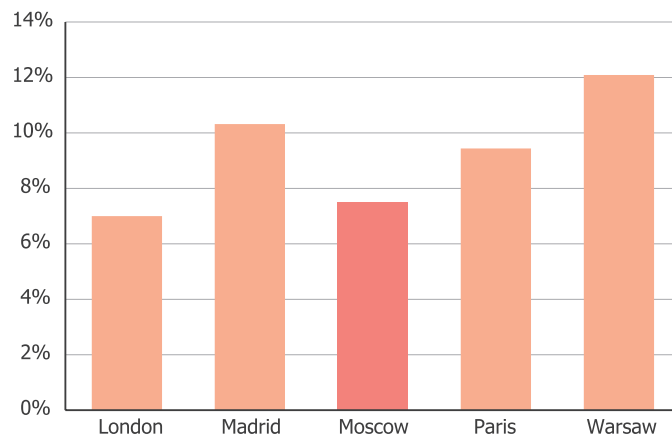
High construction volumes. Record volumes of new construction in 2014 led to 4 pp. vacancy rate increase during the year. Near-completion projects will be delivered in the beginning of 2015, which will lead to further vacancy rate increases in H1 2015. Due to the limited volume of new large announced projects in the second half of the year the new space will be reduced, which will maintain a balance in the market and stabilize vacancy rates at the level of 6–7%. This is a good indicator marking the gradual maturity of the market. Global best practice indicates that a vacancy rate of less than 10% is optimal for both developers and tenants.

Exchange rate risks. Russian rouble instability leads to difficulties in long-term lease contract negotiations. Currently the market is searching for compromise solutions to neutralize the negative impact of currency risks for its participants.

Demand structure changes. Non-food companies are in a difficult position. At the same time, food companies and import-substitution production companies are developing.

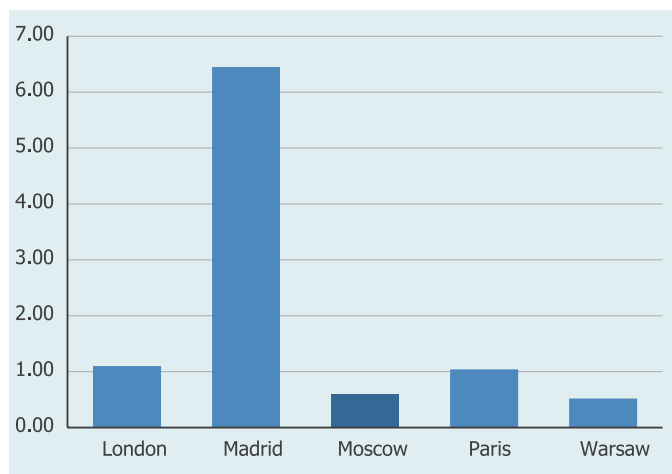
In 2015, **in the Regions**, negative effects from political and economic factors will be more evident than in 2014. However, the demand from food-retail companies is not satisfied in all Russian regions. The speed of new construction will remain high, as there is a lack of quality supply in many regions. (19, 20 ▶)

19 ▶ MOSCOW VS. EUROPEAN CITIES, VACANCY RATE, CLASS A



Source: Cushman & Wakefield

20 ▶ MOSCOW VS. EUROPEAN CITIES, STOCK PER CAPITA, '000 SQ M, CLASS A, B



Source: Cushman & Wakefield

CONSTRUCTION

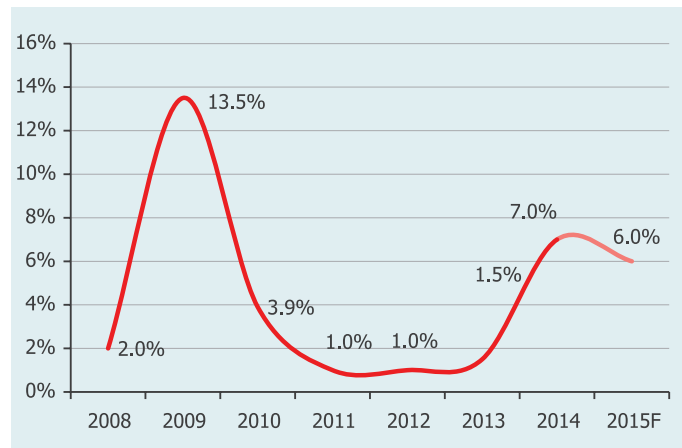
2014 was a historically record year for new construction volumes in the Russian warehouse real estate market.

In the Moscow region supply increased by 1.65 mln sq m and surpassed the 2007 pre-crisis record in which 1.4 mln sq m of warehouse space was delivered. High construction volumes, coupled with the changing economic situation and low tenant activity, caused the vacancy rate increase from 3% to 7% during the year.



In the Regions about 1 mln sq m of quality warehouse space was delivered and the construction geography was extended. In St. Petersburg, the supply increased by more than 370,000 sq m, and in Rostov-on-Don it went up 145,000 sq m. (21, 22, 23 ▶)

21 ▶ VACANCY RATE OF WAREHOUSE PROPERTY, THE MOSCOW REGION, CLASS A



Source: Cushman & Wakefield

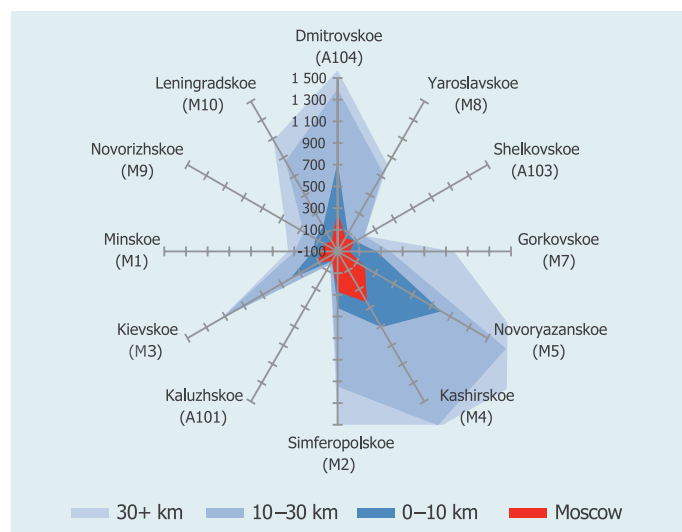
22 ▶ MOSCOW NEW CONSTRUCTION*, 2014

Project	Highway	Distance, km	Total area '000 sq m	Delivery quarter
South Gate IP	Kashirskoye	27	225,00	Q3
Atlant park	Gorkovskoye	39	181,42	Q1, Q4
PNK-North	Rogachevskoye	27	157,85	Q1, Q3
PNK-Chekhov II	Simferopolskoe	50	141,57	Q2-Q4
SST	Novoryazanskoye	31	126,00	Q2, Q4
Nikolskoye LP	Rogachevskoye	35	106,84	Q3
Dmitrov LP	Dmitrovskoye	30	69,30	Q2
Nakhabino II	Novorizskoye	15	68,04	Q1
Nova Riga LP	Novorizhskoye	27	67,85	Q4
Bykovo LP	Novoryazanskoye	19	61,42	Q2

* Key quality warehouse projects

Source: Cushman & Wakefield

23 ▶ GEOGRAPHICAL DISTRIBUTION OF QUALITY WAREHOUSE SPACE BY HIGHWAY, THE MOSCOW REGION ('000 SQ M)



Source: Cushman & Wakefield

CONSTRUCTION (FORECAST)

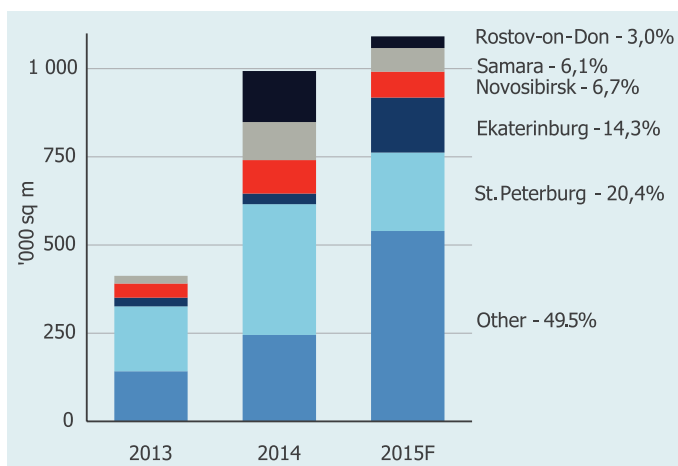
A significant number of warehouse projects are in the planning and construction stage. According to the Cushman & Wakefield forecast, delivery of many of these projects will be delayed. The volume of new warehouse delivery in 2015 will be lower than in 2014. A decline in construction volume will balance supply and demand in the medium term.

In the Moscow Region in 2015, new construction volume will be approximately 1.1 mln sq m (Cushman & Wakefield forecast). Approximately 26% of new construction is built-to-suit (purchase or pre-lease agreements are signed or warehouses are being built by companies for their own use). Most speculative warehouse projects are expected to be de-

livered in H1 2015. Project realization, planned for the end of 2015–2016, is likely to be postponed. In the beginning of 2015, we expect vacancy rates to be increased (these figures will decline in H2 2015). According to our estimates, the vacancy rate will be 6% by the end of 2015 (at the end of 2014 or before).

In Russian regions in 2015, new construction geography will continue to expand following the demand. New quality warehouse spaces are under construction in Vladivostok, Ul'yanovsk, Ufa and other regions. The St. Petersburg warehouse market is developing actively. During the year, more than 25% of all regional construction (excluding the Moscow Region) will be delivered there. (24, 25 ►)

24 ► NEW CONSTRUCTION OF WAREHOUSE PROPERTY EXCEPT THE MOSCOW REGION ('000 SQ M)



Source: Cushman & Wakefield

25 ► NEW CONSTRUCTION* RUSSIA EXCEPT THE MOSCOW REGION, 2014

Highway	Region	Total area '000 sq m	Delivery quarter
a2Logistic	Rostov-on-Don	132,62	Q2, Q4
Armada Park	St. Peterburg	78,88	Q3
PNK KAD	St. Peterburg	66,80	Q3, Q4
Samaratransavto	Samara	61,00	Q3
PNK-Tolmachevo	Novosibirsk	46,65	Q1
Osinovaya Roscha	St. Peterburg	45,00	Q3
Troitskiy logopark	St. Peterburg	42,75	Q4
A Plus Park Pushkin	St. Peterburg	40,00	Q2
Logocenter Kuban	Krasnodar	38,40	Q2
STS	St. Peterburg	33,95	Q2
Logocenter	Chelyabinsk	33,72	Q1
Ermolino	Kaluga	28,10	Q1

* Key quality warehouse projects

Source: Cushman & Wakefield

SN SHERRIZONE-NORD LP LOGISTICS PARK



CLASS A WAREHOUSE COMPLEX
UNIQUE LOCATION
SUPERIOR INFRASTRUCTURE

FIRST PHASE COMPLETION Q4 2014
800 M FROM SHEREMETEVO AIRPORT
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DEMAND

Demand for quality warehouse space is stable in both the Moscow Region and throughout Russia. After the recessionary period in mid-2014 and the transition in contractual relationships, we expect that the market will enter the active phase of deal completion.

In Q4 2014 the total volume of transactions has traditionally been high for this period and amounted to almost half of the total absorption in 2014 (40% in the Moscow region, 45% in the Regions).

In the Moscow Region, a decrease in market activity for Q1–Q3 resulted in a 27% decline in absorption compared to 2013. In 2014, 870,000 sq m of warehouse space was leased and purchased.

The share of purchase transactions in 2014 was 29%, which is 9 pp. lower than in 2013.

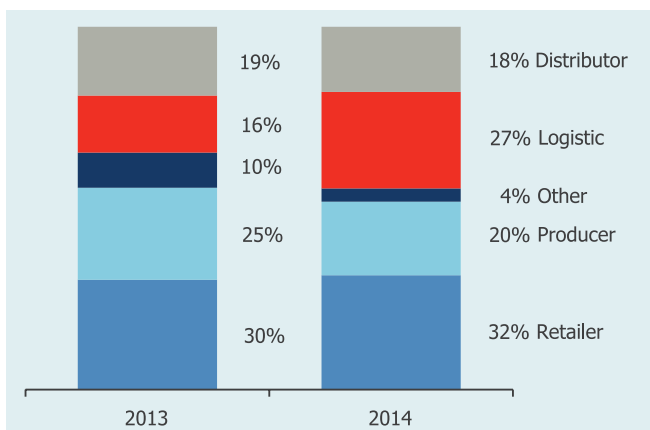
In 2014, the share of logistics companies increased significantly in sectorial demand structure (from 16% to 27%). In both 2013 and 2014, 30–33% of space was leased or purchased by retail companies; and 18–20% belonged to distributors.

In the regions, 545,000 sq m were purchased and leased in 2014. In comparison with 2013, take-up increased by 29%.

The share of purchase transactions decreased from 34% in 2013 to 23% in 2014.

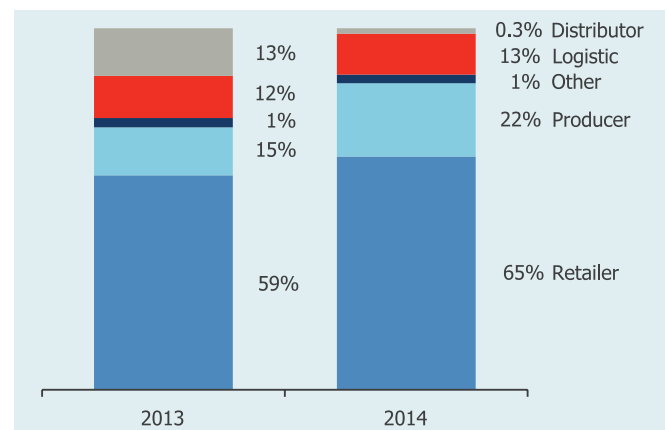
The most active companies in the regional market are retail companies (mainly food-retail) and production companies (primarily car components and industrial equipment production). In 2014, the market shares of these sectors were 65% and 22%, respectively. These figures are higher than 2013 indicators by 6 and 7 pp. respectively. **(26, 27 ►)**

26 ► DEMAND STRUCTURE OF WAREHOUSE PROPERTY, MOSCOW



Source: Cushman & Wakefield

27 ► DEMAND STRUCTURE OF WAREHOUSE PROPERTY, REGIONS



Source: Cushman & Wakefield

DEMAND (FORECAST)

The demand for quality warehouse space remains stable. However, the complexity of individual contractual relationship development, the changing economic situation and modifications in sectorial demand structure will

lead to a moderate 10–15% decline in take-up volume (750,000 sq m in Moscow and 460,000 sq m in the regions). Food retail and production companies will be the engines of demand. (28, 29, 30, 31 ▶)

28 ▶ MOSCOW KEY LEASE DEALS OF WAREHOUSE PROPERTY IN 2014

Tenant	Project	Total area '000 sq m
STS logistic	Sever II Logopark	39.79
Bubble Gum	TLC Tomilino	24.00
Delovye linii	WH on Podolskih Kursantov	21.21
Hoff	Absolut	20.39
KARI	Britovo LP	20.00
RuToys	Rodniki	19.97
Gulliver	Berezhki	19.87
Globus	Frost holding III	18.68
Pony Express	Bulatnikovo	18.50

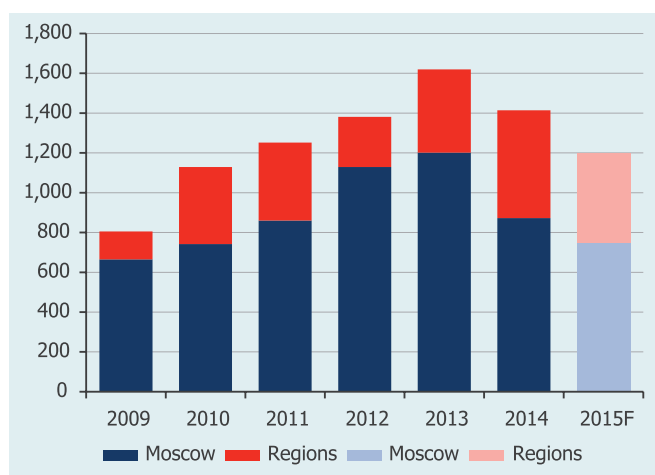
Source: Cushman & Wakefield

29 ▶ RUSSIA EXCEPT MOSCOW REGION KEY LEASE DEALS OF WAREHOUSE PROPERTY IN 2014

Region	Tenant	Project	Total area '000 sq m
Novosibirsk	Holiday-Classic	PNK-Tolmachevo	49.09
St. Petersburg	X5 Retail Group	A Plus Park Shushary	33.45
Rostov-on-Don	X5 Retail Group	a2Logistic Rostov-On-Don	30.19
St. Petersburg	Confidential	Troitkiy	28.50
St. Petersburg	Auchan	A Plus Park Shushary	24.55
Rostov-on-Don	Itella	a2Logistic Rostov-On-Don	18.81
Chelyabinsk	Diksi	Logocentr Chelyabinsk	16.71
Elabuga	Faurecia	A Plus Elabuga	16.22
St. Petersburg	OKEY	Osinovaya Roscha	15.00

Source: Cushman & Wakefield

30 ▶ TAKE UP OF WAREHOUSE PROPERTY, '000 SQ M



Source: Cushman & Wakefield

31 ▶ KEY SALE DEALS OF WAREHOUSE PROPERTY IN 2014

Region	Buyer	Project	Total area '000 sq m
Moscow	Detskiy Mir	PNK-Bekasovo	70.57
Moscow	Confidential	PNK-North	53.19
St. Petersburg	Confidential	A+ Shushary	39.00
Moscow	Confidential	PNK-Chekhov 2	25.19
Novosibirsk	FixPrice	PNK-Tolmachevo	23.35
Moscow	X5 Retail Group	Oriflame Krasnogorsk	22.28
Moscow	DMD-Cargo	PNK-Bekasovo	21.75
Toglatti	Confidential	PNK-Toglatti	20.00
Moscow	Liger Group	Gorki Leninskiye	19.50

Source: Cushman & Wakefield

RENTAL RATES

In the Moscow Region, lease agreements for quality warehouses are historically US dollar-denominated. The Russian rouble devaluation that started in autumn 2014 has led to the need to review contractual relationships with both existing tenants and the proposed new warehouse space. As a result, many flexible schemes for tenant-landlord relationships have been launched: short-term transitioning (1–2 years) of payments to roubles; offering a fixed exchange rate on the non-market level; the possibility to review commercial contract terms during the lease etc. To make the deal, it is crucial to build mutually beneficial, often individualized, contractual relationships between tenants and landlords.

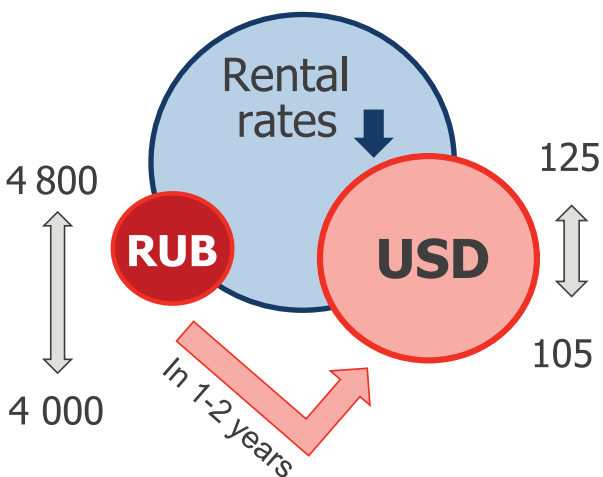
In the long-term period (3–5 years), transitioning to rouble-denominated contracts will not be suitable for all deal participants as rouble contracts imply indexation of

rentals with the Russian CPI. A high inflation rate (more than 10 percent per annum, according to our forecast) will lead to annual rental cost increases.

In the Moscow Region, most likely after a 1–2 year adjustment to new economic conditions, contracts will be denominated in US dollars again.

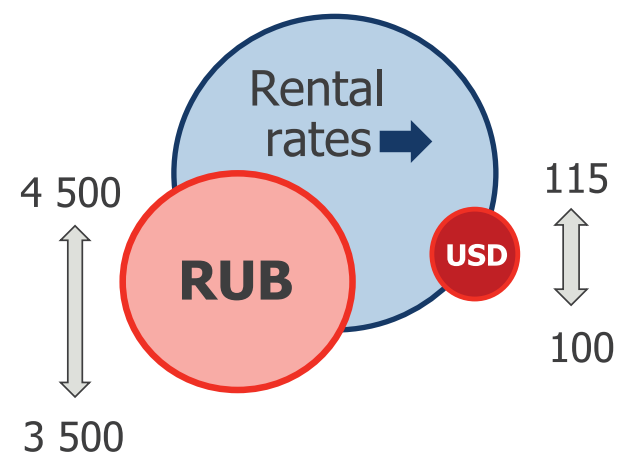
In the Regions, where the local developers used mainly rouble-denominated model, the rouble devaluation in the short-run did not significantly affect the market. From the beginning of 2014 and at present, average rents have been relatively stable. Federal developers with warehouses throughout Russia that usually had lease contracts denominated in foreign currency are offering temporary transition periods similar to the ones seen in the Moscow Region. (32, 33 ▶)

32 ▶ RENTAL RATES OF WAREHOUSE PROPERTY IN MOSCOW REGION



Source: Cushman & Wakefield

33 ▶ RENTAL RATES OF WAREHOUSE PROPERTY EXCEPT THE MOSCOW REGION



Source: Cushman & Wakefield

Hospitality – Moscow hotels in Q4 2014

Operational indicators across all segments of Moscow hotels for the period from January to December 2014 demonstrated a decrease as compared to 2013: average occupancy fell by 4% (67%); both Dollar and Rouble ADR (average daily rate) decreased (21% and 4% respectively) amounting to 188 US Dollars/7,227 Roubles; RevPAR (revenue per available room) nominated in US Dollars decreased by 25% and amounted to 123 US Dollars, RevPAR nominated in Roubles decreased by 7% and comprised 4,740 Roubles.

The upscale segment demonstrated a negative trend compared to January–December 2013. Dollar RevPAR dropped by 23% (178 US Dollars), while RevPAR nominated in Roubles – by 7% (6,871 Roubles). Such a result was reached by a 5% occupancy decrease (62%) and a 17% fall of Dollar ADR (285 US Dollars), while Rouble ADR increased by 1%, amounting to 10,989 Roubles.

Business hotels did not show better results in January–December 2014. Thus, US Dollar RevPAR decreased by 29% (103 US Dollars), which was composed of a 5% occupancy drop (66%) and a 24% fall of ADR nominated in US Dollars (156 US Dollars). The Rouble RevPAR decreased by 14% (3,957 Roubles) in line with a 8% ADR drop (5,961 Roubles).

A certain decrease of ADR and RevPAR was observed in the midscale segment. The overall occupancy demonstrated a slight 1% fall (72%). Both ADR and RevPAR nominated in the US Dollars dropped by 25% amounting to 123 US Dollars and 88 US Dollars respectively. The Rouble ADR and RevPAR decreased by 9% and 10% respectively (4,731 Roubles and 3,391 Roubles)

It is necessary to point out that the extreme fluctuations of the US Dollar against the Rouble had a significant impact on further declines in the Dollar equivalent. As the

US Dollar in January–December 2014 went up against the Rouble by 65.6% (from 33.46 Roubles to 55.41 Roubles), the Dollar figures showed a stronger decline than the Rouble.

An absolute gap in RevPAR between market segments has changed and demonstrated the following results:

The variation between the upscale and midscale segments comprised 90 US Dollars/3,480 Roubles compared to 113 US Dollars/3,611 Roubles in the same period of 2013.

The difference in RevPAR between upscale and business hotels changed to 75 US Dollars/2,914 Roubles vs. January–December 2013 results (86 US Dollars/2,740 Roubles). (34 ►)

HOTELS OPENED IN Q1 2014:

A new Raikin Plaza hotel opened in Moscow on Sheremetievskaya Street, 6/1 in the end of January 2014. The 54-room hotel offers a restaurant, a lobby bar, a conference room, a gym, a beauty salon and underground parking.

A 4-star Intourist Kolomenskoe business hotel opened in March 2014 on Kashirskoe Highway, 39b. The hotel offers 259 rooms, a restaurant, four conference halls for 170 people, ground and underground parking.

Renaissance Moscow Olympic Hotel located on Olympiyskiy Avenue, 18/1 was under Marriott management until mid-December 2013. In the end of April 2014 a 4-star hotel was re-opened after reconstruction under Azimut Hotels & Resort management and offers 486 rooms, seven restaurants, a bar, 16 conference halls, a business center, a banquet hall, a fitness center and parking.

34 ► HOTELS OPENED IN MOSCOW AND MOSCOW REGION IN 2014

Name	Room number	Address	Class
Moscow			
Four Seasons Moscow	180	Okhotny Ryad Street, 2	luxury
The St. Regis Moscow Nikolskaya	210	Nikolskaya Street, 12	luxury
DoubleTree by Hilton Moscow – Marina	270	Leningradskoe Highway, 39, Idg.. 1	4 stars
Azimut Moscow Olympic (former Renaissance Moscow Olympic) – rebranding	486	Olympiyskiy Avenue, 18/1	4 stars
Intourist Kolomenskoe	259	Kashirskoe Highway, 39b	4 stars
Raikin Plaza	54	Sheremetievskaya Street, 6/1	4 stars
Gallery Voyage	560	Avtozavodskaya Street, 23, Idg.. 16	4 stars
Mercure Moscow Baumanskaya	47	Baumanskaya Street, 54	3 stars
Gorod	22	Kievsky Railway Station	2 stars
Total: 9 hotels	2088		
Moscow Region			
Radisson Blu Airport Sheremetyevo	391	Moscow Sheremetyevo Airport	5 stars
Hilton Garden Inn New Riga	164	Novorizhskoe highway, Kostrovo village	3 stars
Heliopark Lesnoy (former Marco Polo Lesnoy) – rebranding	137	Solnechnogorsky area, Peshki village	3 stars
Total: 3 hotels	692		

Source: EY database, open sources, operators' data

A new Hilton Garden Inn Moscow New Riga hotel opened at the end of March 2014 in Kostrovo village, 50 km away from MKAD on Novorizhskoe Highway. The hotel offers 164 rooms, a restaurant, seven meeting rooms, a business center, a fitness center, sports and children's playgrounds and a summerhouse with BBQ.

A hotel, known as Marco Polo Lesnoy, started to operate under Heliopark Hotels & Resorts brand in the beginning of April 2014. Heliopark Lesnoy is located in Solnechnogorskiy area, Peshki village. The hotel offers 137 rooms, restaurants, conference-halls, a swimming pool, a sports ground and parking.

HOTELS OPENED IN Q2 2014:

A new Mercure Baumanskaya hotel opened on Bauman-skaya Street, 54, Moscow in May 2014. The hotel offers 47 rooms, a restaurant and parking.

HOTELS OPENED IN Q3 2014:

Nikolskaya hotel is now being operated by Starwood Hotels and Resorts starting August 2014. The hotel is now called The St. Regis Moscow Nikolskaya. The hotel offers 210 rooms, three restaurants, two bars, a lounge area, three conference halls, a banquet hall, fitness and SPA centers with a swimming pool.

A new 4-star Gallery Voyage hotel opened on Avtozavodskaya Street, 23, bld. 16, Moscow, at the end of August 2014. The hotel offers 560 rooms, a restaurant, conference halls, a fitness center, a sauna, a swimming pool and parking.

A new Gorod hotel opened in the building of Kievskiy Railway Station in Moscow at the beginning of August 2014. The hotel offers 22 rooms, a lounge area and a library. The developer of the project is Vipservice CJSC supported by RZHD public company.

Hilton Worldwide announced the opening of DoubleTree by Hilton Hotel Moscow – Marina located on Leningradskoe Highway, 39, bldg.1, Moscow, in the middle of September 2014. The 270-room hotel offers a restaurant, a lobby bar, 10 conference halls, fitness and SPA centers with a swimming pool, a beauty salon and parking.

The Carlson Rezidor Hotel Group opened Radisson Blu Hotel Moscow in Sheremetyevo Airport, Moscow region, at the beginning of September 2014. The hotel offers 391 rooms, two restaurants, a lobby bar, a 200-square-meter conference center, 47 meeting rooms and parking.

HOTELS OPENED IN Q4 2014:

Four Seasons Hotels and Resorts opened Four Seasons Moscow hotel on Okhotny Ryad Street, 2, Moscow, on 25 October 2014. The hotel offers 180 rooms, two restaurants, two bars, a café, five conference halls, two banquet halls, fitness and SPA centers with a swimming pool and parking.

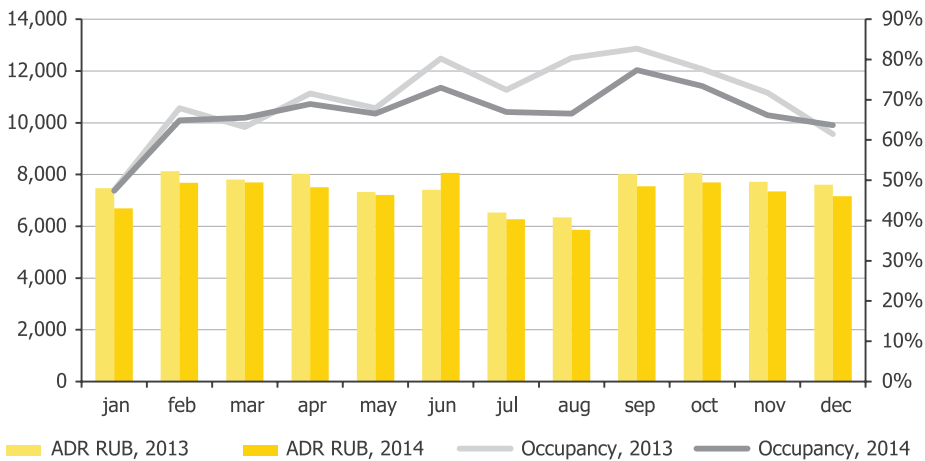
We expect the following hotels to open in 2015. (**35, 36, 37, 38, 39, 40** ►)

35 ► FUTURE HOTELS ANNOUNCED FOR OPENING IN MOSCOW AND MOSCOW REGION IN 2015

Name	Room number	Address	Class
Central Moscow			
Radisson Arena Hotel Moscow	363	Olimpiysky Passage, 1	5 stars
Novotel Moscow Kievskaya	250	Former hotel Kievskaya	4 stars
Adagio Moscow Kievskaya	150	Former hotel Kievskaya	3 stars
Ibis Moscow Kievskaya	300	Former hotel Kievskaya	3 stars
Ibis Moscow Leningradsky	317	Leningradsky Avenue, 37/8	3 stars
Ibis Moscow Oktyabrskoe Pole	242	Marshal Rybalko Street, 2	3 stars
Ibis Semenovskaya	110	Velyaminovskaya Street, 34/23	3 stars
Hampton by Hilton Moscow Strogino	214	Kulakova Street, 20, bldg. 1A	3 stars
Total: 8 hotels	1,946		
Moscow Region			
Four Elements Borodino Club	160	Minskoe Highway, 100 away from MKAD	5 stars
Astrum Hotel Schelkovo	184	Schelkovo, Talsinskaya Street, 1A	4 stars
DoubleTree by Hilton Vnukovo Airport	432	Vnukovo Airport	4 stars
Total: 3 hotels	776		

Source: operators' data

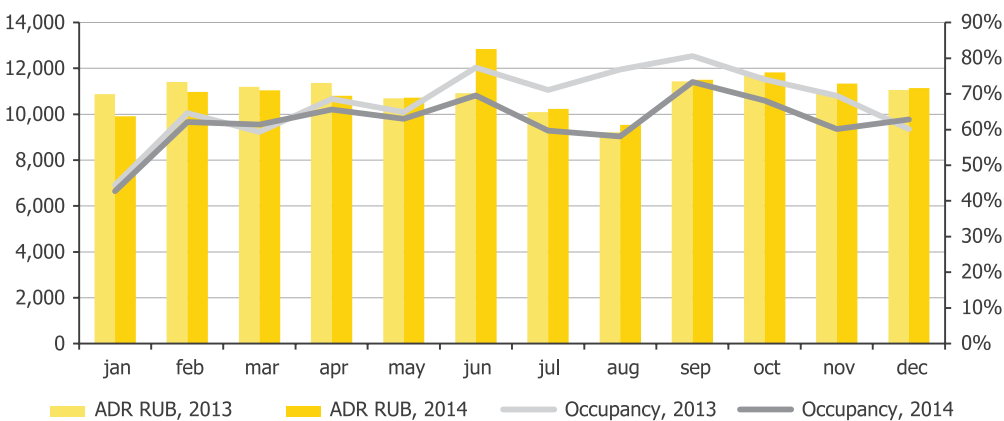
36 ► AVERAGE MARKET ADR* (RUB) AND OCCUPANCY DYNAMICS, 2014 VS. 2013



* average daily rate

Source: EY, Smith Travel Research

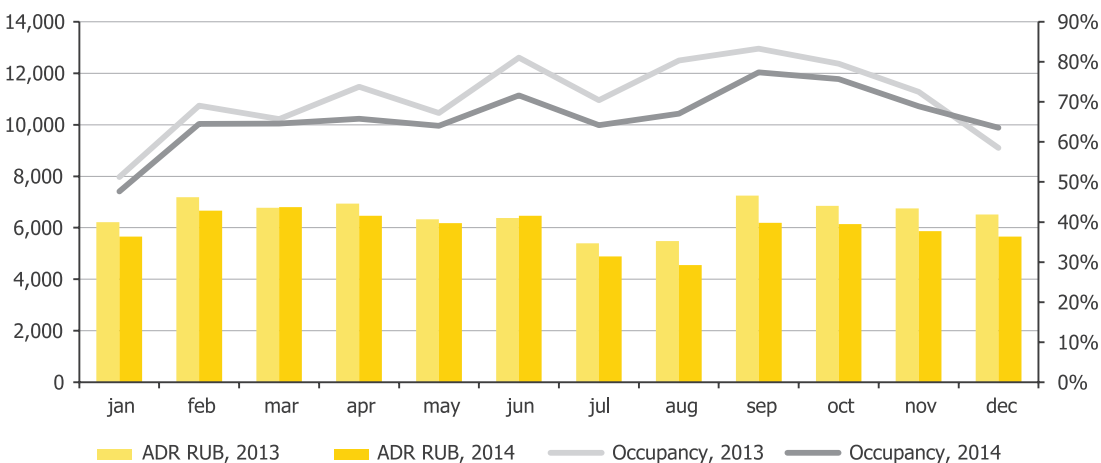
37 ► 5-STAR HOTELS: ADR* (RUB) AND OCCUPANCY DYNAMICS, 2014 VS. 2013



* average daily rate

Source: EY, Smith Travel Research

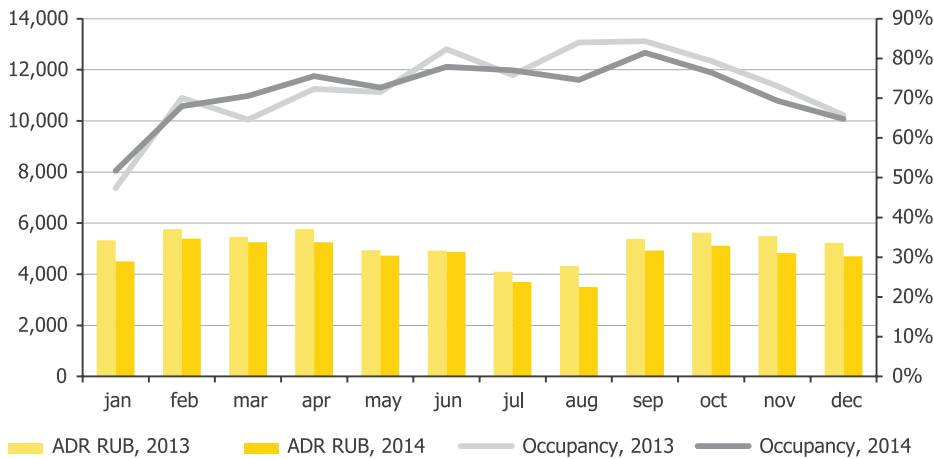
38 ► 4-STAR HOTELS: ADR* (RUB) AND OCCUPANCY DYNAMICS, 2014 VS. 2013



* average daily rate

Source: EY, Smith Travel Research

39 ► 3-STAR HOTELS: ADR* (RUB) AND OCCUPANCY DYNAMICS, 2014 VS. 2013



* average daily rate

Source: EY, Smith Travel Research

40 ► OPERATIONAL INDICES DYNAMICS

	January–December 2014 (US Dollars)	January–December 2013 (US Dollars)	January–December 2014/January–December 2013, %
5 stars			
Occupancy	62%	68%	-5%
Average daily rate (ADR)	\$285/10,989 RUB	\$343/10,907 RUB	-17%/1%
Revenue per available room (RevPAR)	\$178/6,871 RUB	\$231/7,367 RUB	-23%/-7%
4 stars			
Occupancy	66%	71%	-5%
ADR	\$156/5,961 RUB	\$205/6,505 RUB	-24%/-8%
RevPAR	\$103/3,957 RUB	\$145/4,627 RUB	-29%/-14%
3 stars			
Occupancy	72%	73%	-1%
ADR	\$123/4,731 RUB	\$164/5,196 RUB	-25%/-9%
RevPAR	\$88/3,391 RUB	\$118/3,756 RUB	-25%/-10%
Average			
Occupancy	67%	70%	-4%
ADR	\$188/7,227 RUB	\$237/7,536 RUB	-21%/-4%
RevPAR	\$123/4,740 RUB	\$165/5,084 RUB	-25%/-7%

Source: EY, Smith Travel Research

Moscow housing market

QUOTATION:

“In 2015 market will depend on two main factors – geopolitical situation and foreign exchange rates. According to many experts, trends will be negative as a whole and as a result market will not see the growth of the high-budget rental segment. The main recommendations for the owners – flexibility, customer focus and “hold” on stable tenants”.

THESES OF 2014

Entry into the market of substantial amount of new high-quality apartments, which were originally purchased as an investment/rental business. The volume of supplies, which came into the market in 2014 is 19% of the total market, and maximum supply growth marked in following areas: Tverskaya-Kremlin, Arbat-Kropotkinskaya. Thus, potential tenants have an expanded freedom of choice of areas and prices.

Decrease of rental rates – the growth of the US dollar against the rouble has forced nearly one-fourth of owner to reconsider rental rates for their properties. As a result, the average price of high-budget apartments in Moscow declined by 17%. The size of owners’ discount is about 10–40% of the original cost. It is worth noting that not all owners have responded to the growth of currency difference, many of them expect stabilization of the market. Too early to talk about the

final formation of the downward prices movement; in future it will depend on news from financial markets.

Fixation of rental rates in roubles at the specific rate – another way of landlords to adapt to new financial realities. This measure use some owners, who are not looking for dollar income or who need a stable income from lease, because now rouble prices are much more attractive for potential tenants.

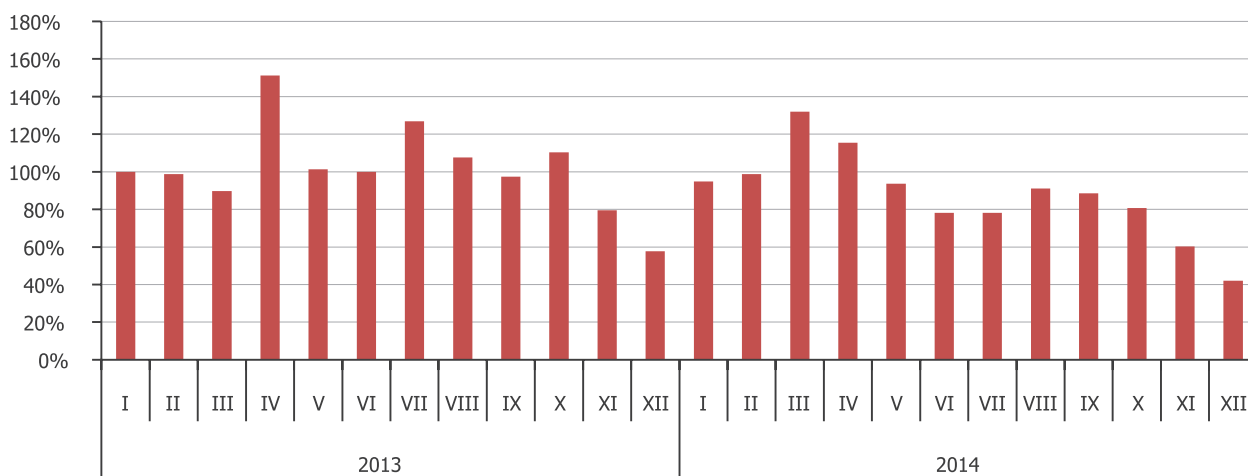
Check out of tenants with high budget – at the end of the year a large number of tenants, who occupied high-budget objects, did not prolong their rental contracts. Intermark also notes the reduction in demand for objects with a budget from \$15,000 and up by one-third in comparison with a year earlier.

DEMAND

By the end of 2014 demand for high-budget property decreased by 9% compared with 2013 year. In this case, slowdown had already been noted in the first half, when the volume of demand reduced by 4%. Objective factor of reducing of some transactions was aggravation of tension and uncertainty in sphere of foreign policy and in economy.

41 ► DYNAMICS OF DEMAND OF MOSCOW’S PRIME RENTAL MARKET (JANUARY 2013 – 100%)

(% — the level of demand)



Source: Intermark Relocation

We note that March was the most active month of this year – tenants began to make preparations for relocation earlier than last year (the highest activity was recorded in April). Summer months traditionally were less abundant in high-budget property deals. **(41 ▶)**

Intermark Relocation estimated that in 2014 the proportion of foreigners in the pattern of demand for high-budget rent was two-thirds of all requests, the same as in 2013 year. Proportion of Russians in the pattern of demand is 26% and tenants from other CIS countries – 8%. **(42 ▶)**

In the age pattern the largest proportion of tenants (40%) is from 35 to 45 years old. More than half (55%) of customers, who prefer luxury apartments, are couples. 47% relocate with children and the majority has two or more children.

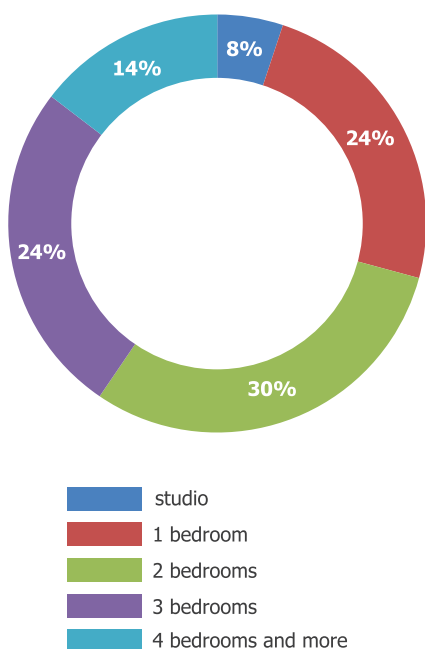
In 2014, as in 2013, most of all tenants were interested in apartment with two bedrooms – 30% of the requests.

Almost a quarter of requests were for apartments with one and three bedrooms, that also shows the popularity of these formats. Apartments with 5 or more bedrooms (14%) and compact studio apartments (8% of the requests) were less popular among tenants.

In most cases, tenants were interested in apartments with the minimum budget to \$4,000 (35% of requests). Last year, the volume of such requests was estimated at 38%. We note an increase of requests with the budget from \$4,000 to \$6,000 – now it accounts 24% of total requests, compared with 20% at the end of 2013. However, this increase is a result of transition from more expensive budget. Requests proportion for budgets from \$10,000 and above per property per month decreased by 2% and now is estimated at 18% of the total demand. **(43 ▶)**

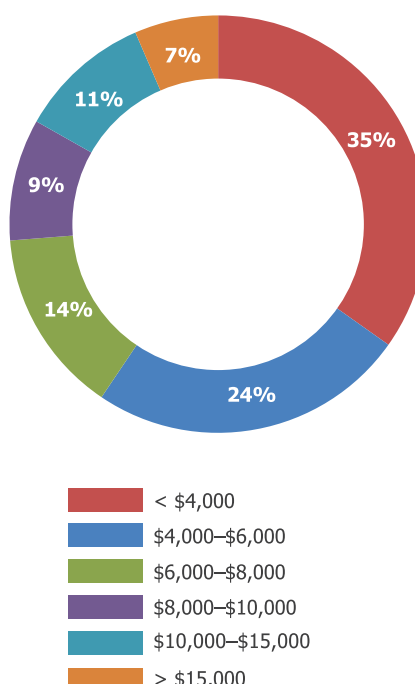
Geographically, at year-end 2014 demand was as follows: first place took Leningradsky Prospect (12%) – high interest

42 ▶ SUPPLY ANALYSIS OF THE HIGH-BUDGET SEGMENT OF THE RESIDENTIAL RENTAL MARKET IN MOSCOW IN TERMS OF NUMBER OF ROOMS



Source: Intermark Relocation

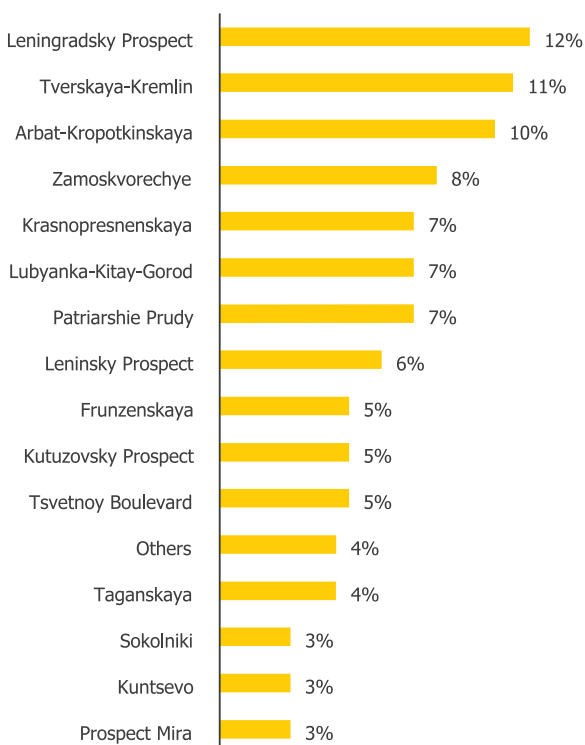
43 ▶ SEGMENTATION OF THE DEMAND ACCORDING TO THE RENTAL VALUE OF THE PROPERTIES IN MOSCOW'S PRIME RENTAL MARKET



Source: Intermark Relocation

44 ► TERRITORIAL STRUCTURE OF DEMAND IN THE RESIDENTIAL RENTAL MARKET OF MOSCOW (MOST POPULAR AREAS) (JANUARY – DECEMBER 2014)

(% — the share of the area in the overall structure)



Source: Intermark Relocation

of tenants is provided due to the international residential complexes and prestigious low-rise villages in this area. Further, with a minimum margin goes area of Tverskaya Street (11%) and Arbat Kropotkinsky area (10%). We note a slight decrease of tenants' interest to the area of Arbat and Kropotkinskaya in the territorial structure of demand. At the end of the last year, proportion of tenants, who interested in these regions, was 16%. Obviously it is a result of weakening of tenants' interest to the most expensive budgets, because Arbat area has the highest rates in Moscow. (44 ►)

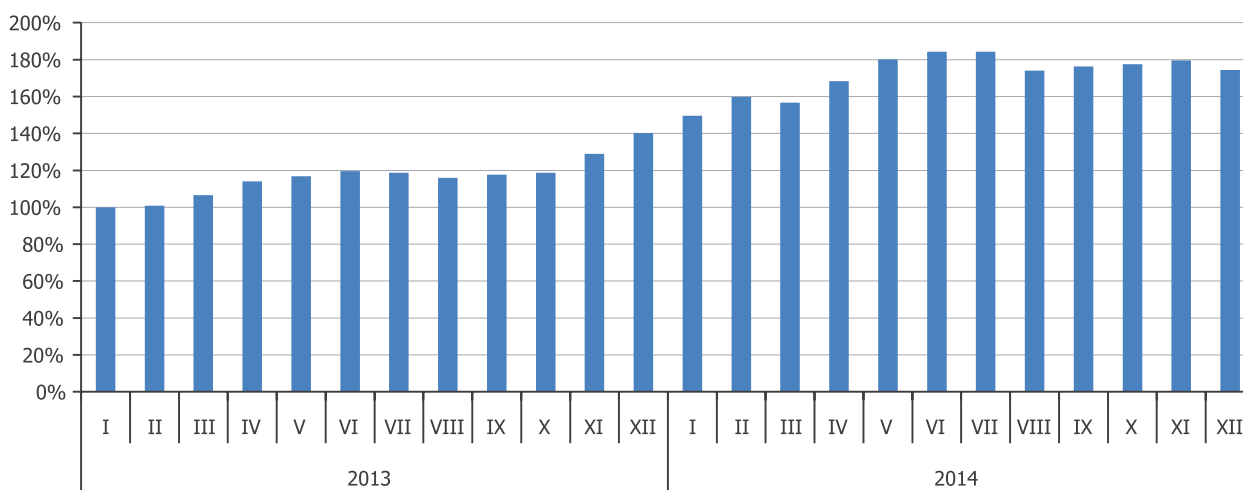
SUPPLY

According to Intermark Relocation analysis, since the end of 2013 supply of vacant high-budget apartments in Moscow increased by 24%. The most active growth of supply was observed in the first half of 2014: the peak of growth was recorded in July 2014 (+32% compared with December 2013).

In 2014 the seasonality of demand significantly influenced on dynamics of supply. Against the background of general increase of available properties, high season of demand for rental property in the beginning of the year restrained growth of supply. However, this summer season has allowed us to capture the maximum amount of available rental apartments and already in autumn growth of supply decelerated with increasing of potential tenants' activity. (45 ►)

45 ► DYNAMICS OF SUPPLY OF MOSCOW'S PRIME RENTAL MARKET (JANUARY 2013 – 100%)

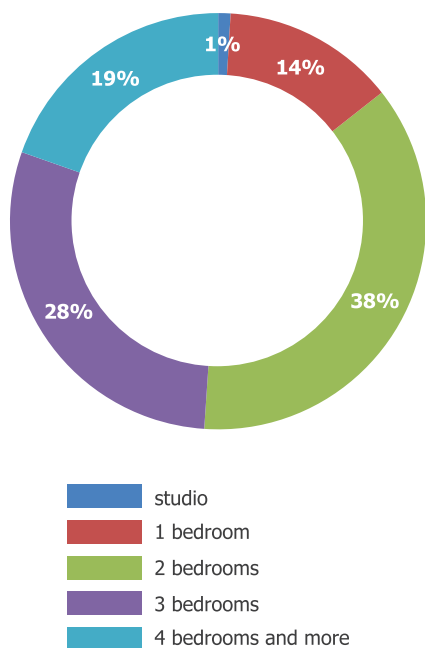
(% — the level of supply)



Source: Intermark Relocation

Besides newly available apartments, new objects entered the market. Their share was almost a fifth of the total market (19%), while rental rates for such items higher on average by 4% than average market. (46 ▶)

46 ▶ SUPPLY ANALYSIS OF THE HIGH-BUDGET SEGMENT OF THE RESIDENTIAL RENTAL MARKET IN MOSCOW IN TERMS OF NUMBER OF ROOMS

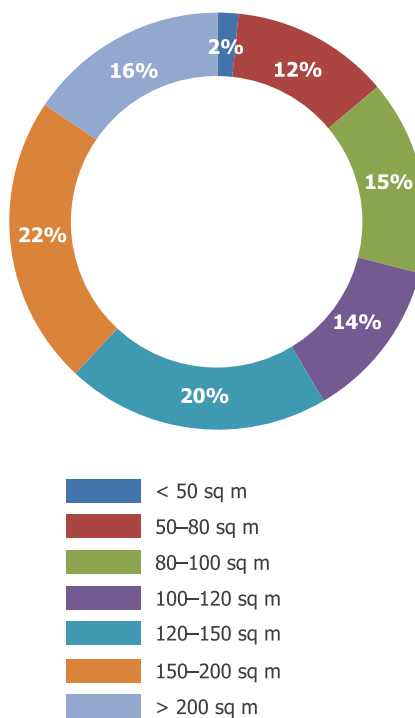


Source: Intermark Relocation

In early 2015 we expect continuation of growth of vacant apartments, including those, which entered the rental market for the first time.

The largest share of rental apartments (38%) – 2 Bedroom variant. Apartments with 3 bedrooms (28%) take the next share. Such variants are the most optimal for tenants with 1–2 children. Studios and 1 bedroom apartments take the smallest part of the market and their total volume does not exceed 15%. We note that during the last year the structure of the market in terms of number of rooms practically didn't change. (47 ▶)

47 ▶ SUPPLY ANALYSIS OF THE HIGH-BUDGET SEGMENT OF THE RESIDENTIAL RENTAL MARKET IN MOSCOW IN TERMS OF SQ M



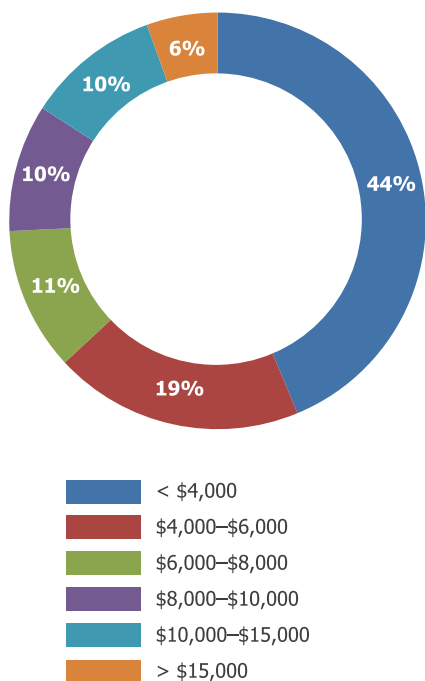
Source: Intermark Relocation

In footage rating the main share take apartments with area of 120–150 sq m and 150–200 sq m – 21% and 22% respectively. In 2014 the biggest supply increase was among apartments of 150–200 square meters and over 200 square meters. Their amount increased by more than 50%.

The largest share of apartments with rental budget to \$4,000 per property per month. But compared with last year, share of apartments with a minimum budget become more significant for high-budget rent – 44% against 28% in last year. This "movement" is a result of a revision of owners of rental rates due to the growth of dollar and the growing volume of supply-risk of long exposure in the market.

Upper price segment of high-budget rent also met changes: amount of apartments in the most expensive segment of \$15,000 per property per month reduced by quarter and increased the volume of apartments with \$8,000–\$10,000 rate per property per month. (48 ▶)

48 ► SUPPLY ANALYSIS OF THE HIGH-BUDGET SEGMENT OF THE RESIDENTIAL RENTAL MARKET IN MOSCOW IN TERMS OF RENTAL BUDGET



Source: Intermark Relocation

Constant leader of the high-budget apartments supply – Arbat-Kropotkinskaya area. Over the past year the number of apartments in this area increased and now accounts for almost a quarter of the total supply (23%), compared with 20% of the last year. But more rapid growth in the demands was recorded in the area of Tverskaya Street and Kremlin. For the year supply in this area increased by 60%, and now its share is 13% (second place) of the total. (49 ►)

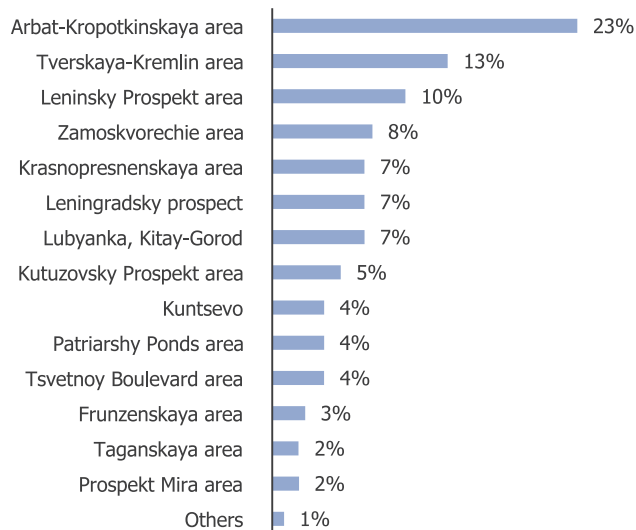
RENTAL RATES AND BUDGETS

As of December 2014 the weighted average budget of demand was \$6,370 per property per month. Against the corresponding figure of 2013, decline was about 17%, and in December 2013 the weighted average budget of demand was \$7,650 per property per month.

Since the beginning of autumn 2014, when exchange rate fluctuations have become more significant, almost every fourth owner (23%) decided to reduce the price of his prop-

49 ► TERRITORIAL STRUCTURE OF SUPPLY IN THE RESIDENTIAL MARKET OF MOSCOW (DECEMBER 2014)

(% — the share of the area in the overall structure)



Source: Intermark Relocation

erty. Price adjustment was in the range of 10% and reached 40% of the original price, or fixing rental costs in roubles. The most expensive properties, whose owners want to rent an apartment out as soon as possible, took a maximum discount.

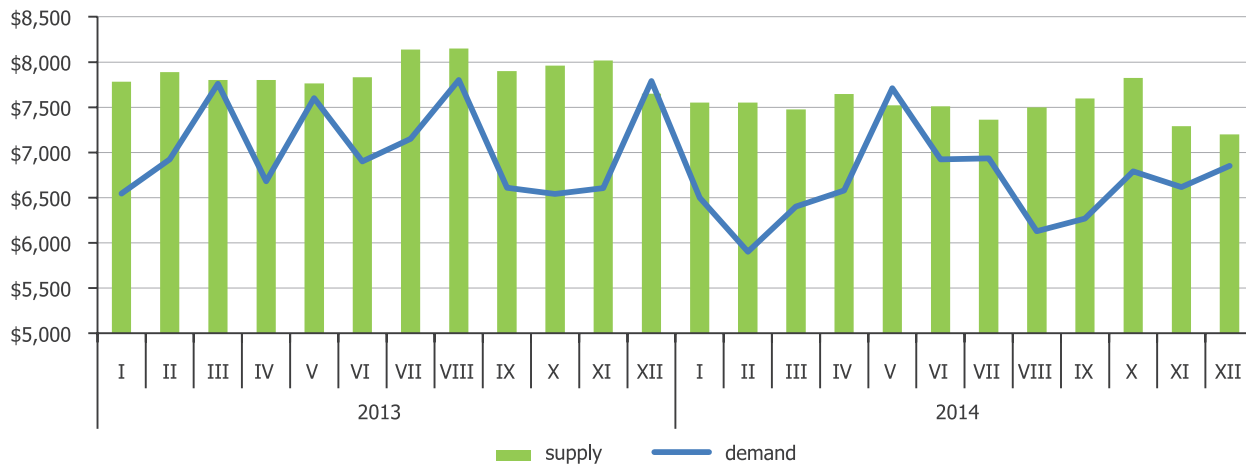
Unit rental rate, which is calculated as the cost of rent, per square meter of rental area for the year, was \$539 per sq. m. per year. During the year this figure decreased by 21%. This change is caused not only by reducing of rental budget, but also by increase of supply of apartments with large footage. Thus, rental rate per area unit became smaller.

The most expensive area in supply is Arbat-Kropotkinskaya. The average price for property is \$8,900 per property per month. In the second place is Krasnaya Presnya area, its average budget was \$7,140 per property per month. This area firmly took a root in rating due to supplies in the skyscrapers MIBC “Moscow-City”, where prices for apartment rent above the average. In third place is Patriarshie Prudy with an average rental rate of \$6,760 per property per month. Area of Tverskaya Street and the Kremlin is the line below: average budget was \$6,630 per property per month. Chistiye Prudy and Lubyanka area is also famous among tenants due to the prestigious French Lyceum in this area.

Average requested budget for apartment rent from potential clients at the end of 2014 amounted to \$6,850 per property per month, what is inconspicuous less than in 2013 – minus 3%. During the first three quarters of 2014, this figure ex-

ceeded in importance 2013 year. But since September 2014 due to the events on the financial markets, the average budget, requested by tenants, was declined. First of all, it shows that the majority of tenants are rouble-oriented. (50 ▶)

50 ▶ DYNAMICS OF THE AVERAGE OFFER PRICE FOR THE TENANCY IN MOSCOW'S PRIME RENTAL MARKET



Source: Intermark Relocation

St. Petersburg market overview

Office

Completion levels in 2014 were by 10% less than in 2013. In 2014 219,110 sq m in 22 office buildings were completed. 54% of new space refers to Class A. Total modern office stock amounted to 2,649 mln sq m, which corresponds to 509 sq m per 1,000 inhabitants. **As usual the most part of new business centres were commissioned in the last quarter.** 87,850 sq m in 9 buildings were completed in Q4 that correspond to 40% of total completion levels in 2014. Nevertheless this Q4 volumes were by 25% less than in Q4 2013. Four completed business centres were Class A buildings, five refers to Class B. The largest project is Trinity Place BC (27,000 sq m leasable area, Class A), marketing stage if which was stopped before date of completion. Probably this object were leased out by Gazprom company.

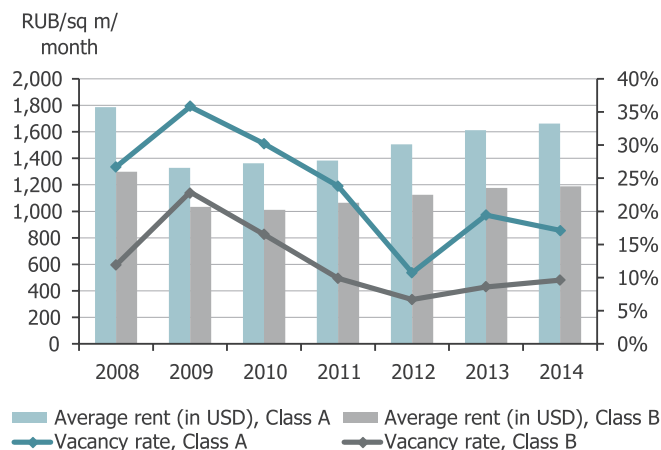
Net absorption levels in Q4 2014 were 77,460 sq m, which is the highest levels for the last quarter in the record and the highest quarterly results since Q2 2011. In whole 2014 the net absorption levels reached 189,210 sq m, that is by 47% more than in 2013. The high level of absorbed space in the last quarter was due to some big deals by federal companies. Namely by Gazprom, which leased a number of new business centres, and VTB, who leased one of building in Nevskaya Ratusha BC. These transactions formed 95% of quarterly net absorption, or 74,220 sq m.

The transfer of Gazprom and its affiliate companies to St. Petersburg is the main reason for the leading role of Mining and Exploration in leasing deals structure. Only in 2014 these companies have leased and bought more than 80,000 sq m office space. For example in 2014 Gazprom closed the largest deals for St. Petersburg market in Trinity Place BC, Electro BC and Zeppelin BC.

In Q4 2014 rouble rents slightly increased by 1.5% in Class A and by 1.8% in Class B. Average rental rate is equal to 1,660 roubles per sq m/month (including VAT and OpEx) in Class A and 1,190 roubles in Class B. Due to great weakness of rouble, dollar rents in Class A segment felt down by 26–28%. Compare with Q4 2013 rouble rents increased by 3% in Class A and by 1% in Class B.

The average vacancy rate at the end of 2014 amounted to 12.0%, that is by 0,2% more than at the end of 2013. Vacancy rates have decreased in Class A from 19.4% at the end of 2013 to 17.1% at the end of 2014, in Class B rates have increased from 8.6% to 9.6%. On Q4 2014 there were no changes in vacancy rates as for whole city, as for different classes. (51 ►)

51 ► OFFICE MARKET BALANCE

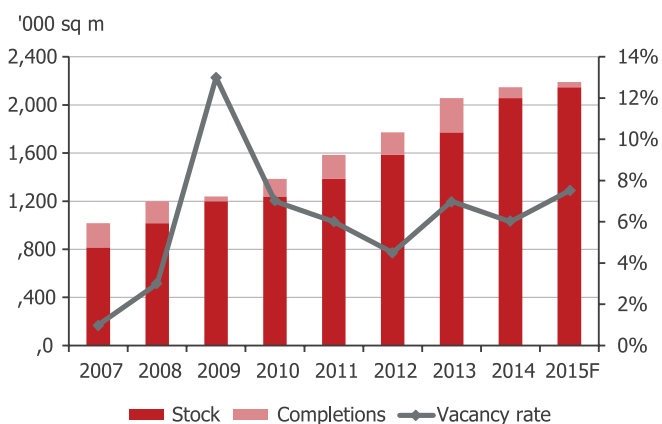


Source: JLL

Shopping Centre

According to the results of 2014 the size of the St. Petersburg retail market amounted to 2,147 mln sq m of quality retail space. (52 ►)

52 ► SHOPPING CENTRE STOCK AND VACANCY RATE DYNAMICS



Source: JLL

Two shopping entertainment centres with the total leasable area of 91,000 sq m were delivered to the market in

2014, both of them were commissioned in H2 2014. There are Monpansye SEC (30,500 sq m GLA) and Europolis SEC (60,500 sq m GLA). This total volume the lowest volume for the last three years. Two shopping entertainment centres with a total leasable area of 42,400 sq m will be delivered to the market by the end of 2015. In Q4 2014 the vacancy rate in St. Petersburg SECs increased up to 6.0% and we expect the further increasing in vacancy rates in 2015 up to 7–8%.

Prime base rental rates for retail gallery space in quality shopping centres in Q3 2014 declined to \$1,500/sq m/year (rents exclude VAT and OPEX). The main reasons for this decreasing are weakness of rouble and negative macro-economic expectation, especially about income growth. Along with this, during the quarter there were rental rate changes for some tenant profiles. Retailers are increasingly pushing to renegotiate lease terms due to rouble weakness and the uncertain economic and political situation. In some cases developers are ready for nominate rents in roubles, even before they nominated rents in USD or Euro.

Warehouses

Total leasable area of 400,470 sq m of new warehouse space were delivered to the market in 2014, this is the highest volume for the last six years. 43% of new completed space (173,535 sq m) were delivered to the market in Q4 2014. Consequently the total volume of quality warehouse space reached 2,415 m by the end of December 2014.

We forecast about 350,000 sq m of new quality warehouse space will be delivered to the market in 2015. The share of owner occupied warehouse complexes and built-to-suit

projects is almost 80% in the future completions (for 2015). In Q1–Q4 2014 the net absorption reached 267,810 sq m (36% or 96,190 sq m in Q4 2014) this is the highest volume for the last seven years.

In the last quarter of 2014 the vacancy rate increased up to 6.9% (4.0% in Q3 2014). In Q4 2014 the asking rental rates decreased to \$80–85/sq m/year (without OpEx and VAT). The considerable rental rate decreasing in Q4 2014 was mainly due to significant rouble weakening in autumn 2014.

Hot Topic:

Real Estate Lease: Does the Lessee Have any Way Out?



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The processes currently observed in the Russian economy are certainly exerting great influence on the real estate market, including commercial areas lease market (trade centers, offices, warehouses, etc.). First of all, such changes make lessees give thought to optimization of their rent expenses. As a result, more and more lessees of trade, office, and warehouse premises are revising their rent expenses trying to find more beneficial alternatives acceptable in the current conditions – offices of a lower class, premises with a smaller area or those located farther from the center – for the purpose of reducing the rent expenses. Meanwhile, a lessee can by no means always simply cancel the existing contract relations (which are generally long-term ones) with the lessor. So what can a lessee do if such a lessee has decided to cancel the lease? Which options does a lessee have?

It should be noted that in case of absence of any violations from the part of the lessor, the lessee can cancel the lease relations in quite a simple way only in one case: if the relevant lease contract envisages the so-called “break-option right” for such a lessee – the right for extrajudicial cancelling of the contract (at any time or upon expiration of a fixed lease period) with prior notification of the lessor thereof. It should be noted that the contract may envisage the break option right both with payment of reimbursement to the lessor and without payment of such reimbursement (which is an ex-

tremely rare case in practice). As a matter of practice, lessors grant such a right to lessees under the contract terms not very often.

Other ways for a lessee to cancel the contract relations are more complicated. Thus, on the whole, cancelling the contract by the lessee is possible in the following cases: first, as a result of declaring the contract not concluded – in case it does not contain any material terms and conditions; second, as a result of declaring the contract invalid (void or voidable) – for instance, if it was signed by unauthorized persons, or if it was not duly approved by the authorized governing bodies of the parties; third, as a result of judicial termination of the contract in connection with certain violations from the part of the lessor on the grounds envisaged by Article 620 of the Civil Code of the Russian Federation (in particular, if the property transferred to the lessee has defects hampering the use thereof; if the lessor fails to perform the property capital repairs being the obligation thereof within the period fixed by the lease contract, or within a reasonable period if not specified in the contract; and also if the property is in unusable condition due to circumstances beyond the reasonable control of the lessee) and on the grounds envisaged by the lease contract; fourth, as a result of extrajudicial termination of the contract by the lessee in connection with certain violations of the lessor (if such a right of the lessee is envisaged by the lease contract). However, the said ways of cancelling lease relations are

not “unconditional” and are mostly connected with the necessity of proving either certain legal “defects” of the lease contract or specific violations of the lessor.

Moreover, one more option of cancelling the contract by a lessee is worth mentioning – early judicial termination of the lease contract under Article 451 of the Civil Code of the Russian Federation due to the so-called “material change of circumstances”. Taking into account a considerable jump of foreign currency rates at the end of 2014 and the beginning of 2015, and absence of opportunity to cancel the contract on the said grounds, many lessees will undoubtedly try to have recourse to this specific ground for the purpose of cancelling the lease contract. It should be noted that the lessee shall have the right to demand termination of the contract in a judicial procedure under Article 451 of the Civil Code only unless the parties to the lease contract have explicitly excluded the effect of the said Article in the contract.

However, as the current judicial practice shows us, judges sustain claims on termination of lease contracts under Article 451 of the Civil Code of the Russian Federation only in exceptional cases. Thereat, up to date, a considerable increase of foreign currency rates within the period of the lease contract performance has not been attributed by courts to material change of circumstances granting the right to the lessee to cancel the lease contract. However, it is not improbable that in the current situation the approach of courts in relation to this issue can be changed.

If all the said ways of cancelling the lease contract by the lessee are “closed”, the only possible option for such

a lessee is negotiating with the lessor for the purpose of reaching a certain financial compromise (changing of extremely negative financial conditions for more compromise ones, such as revision of the rent amount, temporary fixing of the foreign exchange rate for the purpose of calculating the rent, temporary “non-application” of provisions on the rent indexation). It should be noted that any such arrangement shall be fixed by signing a relevant additional agreement to the contract, as well as its registration (if the contract is a long-term one).

As a matter of practice, lessees manage to agree with lessors on complete cancelling of the lease contract only in exceptional cases, and only if there is a new lessee to replace the existing one, but it is quite real to agree on some compromise option of commercial conditions. Thereat, the so-called “not legal” component of the parties’ relations definitely plays an important role, meaning individual approach of the lessor to each lessee thereof (here many factors are important: the lessee being an anchor one or not, the financial position of the lessee as of the date the transaction is made and as of the current date, specifics of the lessee’s business, history and duration of lease relations with this lessee, etc.). In practice, the lessors often demonstrate sound understanding of the fact that the lessees having concluded the lease contracts prior to September of 2014 and being bound by the rent payments in foreign currency equivalent have found themselves in a more difficult and disadvantageous situation as compared to the new lessees that entered the contract relations later. Understanding that, the lessors are often ready to reach a certain compromise (appropriate in such circumstances) with the lessees on an individual basis.

Hot Topic:

State and municipal land plots: new rules for circulation as of 1 March 2015. Forewarned is forearmed!



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Of Counsel, Dentons
St. Petersburg

On 1 March 2015, Federal Law No. 171-FZ of 23 June 2014 on Amending the Land Code of the Russian Federation ("Law 171-FZ") enters force.¹ The amendments made to the RF Land Code concern state and municipally owned land plots.² The significant extent of these amendments is evident from the fact that six new chapters have been added to the Land Code, which not only change certain mechanisms (for example, provisions regulating the granting of public plots into ownership or lease have been totally revised), but also establish completely new legal concepts. In part, a "permitting" procedure for use of public land plots has been introduced (i.e., without a procedure for granting a plot and establishing an easement, but rather on the basis of a respective permit from the authorized executive authority) for the purposes of conducting engineering surveys, geological studies of subsurface resources, and construction of temporary structures.

The amendments to the Land Code required changes to more than 30 regulatory acts, among which are the Civil Code, the Town-Planning Code, the Administrative Violations Code, and the Federal Law on State Registration of Rights to Real Property and Transactions Therewith. The changes are so significant that the adoption of Law 171-FZ has come to be known as the "land reform". So what is fundamentally new and what should we be prepared for? Let's examine a few of what we consider to be the most important changes.

The main principle established by the new chapter V.1. of the Land Code is that an auction is required for the sale or leasing out of public land plots. The mechanism envisaged in the current version of the Land Code for granting land plots, with preliminary approval of the location for siting an item of real estate or without such approval, as well as the respective procedures for select-

¹ With the exception of certain provisions that entered force as of the publication of the law, i.e., 24 June 2014.

² For the sake of convenience and brevity, below we shall refer to such land or land plots as "public" land or land plots.

ing a land plot for construction and the adoption of a decision on its granting, shall cease to be in force from 1 March 2015. An exception to this is a situation in which a decision on the preliminary location for siting an item of real estate was adopted before 1 March 2015. In this case, a public land plot may be granted to an entity for lease without an auction prior to 1 March 2018 in the procedure established in the current version of the Land Code.

As of 1 March 2015, the sale or lease of land plots without an auction will be possible only in the specific situations expressly set forth in the Land Code. One of these exceptions is sale of a public land plot without an auction to the owners of buildings and structures thereupon or of premises within such buildings and structures. The other exceptions regarding sale without an auction are mostly connected with the integrated development of the land (known as "KOT"), individual residential construction, and agricultural production. Law 171-FZ prohibits the sale of public land plots whose main type of permitted use is construction of buildings or structures. In order to be developed, such land plots must be leased³ through an auction to developers.

Granting a land plot for lease without an auction (including for construction purposes) is possible only if one of the 32 grounds set forth in Law 171-FZ is applicable. Most of these grounds are not relevant to businesses (such as granting a land plot to non-commercial or religious organizations or to individuals for various reasons), and

some are indeed exceptional situations (such as land plots with nuclear facilities, reservoirs or hydrotechnical facilities, and land plots where the extraction of aquatic biological resources or agricultural production takes place). Situations that may be relevant to businesses are cases connected with the granting of plots based on acts issued by senior RF officials, specifically, the granting of a land plot on the basis of a decree from the head of an RF constituent territory (i.e., Moscow, St. Petersburg and Sebastopol) for certain targeted purposes set forth in the law, such as for the siting of sociocultural or public utility facilities or for implementation of large investment projects. However, it should be kept in mind that such projects must meet the criteria established by the laws of the respective RF constituent territory.

Let us examine one particular feature of Law 171-FZ that is significant for developers and investors. Rules have been added to the RF Civil Code establishing that if a lease agreement for a public land plot that was granted in an auction ceases to be in effect, any structures under construction located thereupon may be seized from the owner by court order by means of sale at public auction. After such seizure, the land plot may be granted for lease without an auction to the entity that acquired the ownership rights to the incomplete structure in the auction for the sale of such structure, but this may only occur once and for the purpose of completing the construction. In specific cases set forth in law⁴, a land plot may be granted without an auction to the initial owner of the incomplete structure, however this also may only

³ Law 171-FZ establishes exceptions in which sale of such land plots is possible. This is set forth in an exhaustive list of cases analogous to the list permitting sale of public land plots without an auction.

⁴ If the authorized agency within 6 months of the expiry of the lease agreement entered into earlier for the land plot on which the incomplete structure is located has not submitted a claim to court regarding seizure of the structure, or if the court has denied such a request, or if the structure was not sold because there were no participants in the auction.

occur once and only for the purpose of completing the construction. In other words, both the initial developer and an investor potentially interested in acquiring an incomplete structure are bound by the previously agreed features of the structure. It is very likely that this limitation, if it is strictly implemented in a literal manner in practice, will negatively affect the level of interest shown by investors in acquiring incomplete structures.

It is clear that the purpose of introducing the above rules regarding seizure of an incomplete structure is to avoid unfinished construction projects and encourage developers to complete construction of facilities during the term of the land plot lease agreement. However, there are still questions as to whether the incomplete structure should be registered as real property and whether a "set" of construction materials located on the plot may

be seized/sold. Law 171-FZ does not provide an answer to these questions, since it does not include a clear definition of or criteria for the concept of an "incomplete structure". However, taking into account the provisions contained in the Procedure for Conducting Public Auctions for Sale of Incomplete Structures, approved by RF Government Decree No. 1299 of 3 December 2014, there are grounds to assume that the legislators intend "incomplete structure" to mean a structure whose title is registered in the Unified State Register of Rights to Real Property and Transactions Therewith. In this case, there is serious doubt that the aim intended by the legislator will be achieved, since there is nothing stopping a developer from not registering a title to an incomplete structure (unless the developer plans to somehow sell the incomplete structure), and thus avoiding the possibility of such rules on seizure being applied.

Hot Topic:

Opportunities during Uncertain Times



Miles Jones
CEO, Griffin Partners

Economic downturns – it seems that we are experiencing these crises regularly now – often provide opportunities. There are multiple options for tenants in the warehouse property sector now but they have to choose carefully between them and think several moves ahead to provide a win/win strategy in a long-term period.

The warehousing property segment is generally considered by institutional investors to be one of the most stable and safe real estate asset classes. However, the warehouse sector in Moscow, while indeed stable over the long-term, is highly sensitive to macro-economic fluctuations in the short-term. Due to a peculiar supply/demand structure in the region and construction lead times the warehouse market tends to react to economic downturns with a quick increase in space vacancy. And just as quickly, vacancy gets absorbed – more on that below. As vacancy increases it's possible for tenants to negotiate more favorable conditions.

And the first thing that comes to a tenant's mind is to push for huge discounts on the rent rate, which would be a logical conclusion during times of economic stress. But this strategy also entails risks in the longer term.

In the warehouse sector, the landlords who offer steep discounts are usually in financial difficulty. An example of this fact occurred in 2009 and 2010 after the 2008 financial crisis. Many lessees had taken advantage of the crisis to find deep discounts from several warehouse landlords who were active in the market at that time. Shortly after many of these lessees faced situations where their

landlord went into bankruptcy proceedings followed by litigation, forced moves, title-deed issues, etc. Other lessees were confronted with take-it-or-leave-it rate increases from new owners. Obviously, such difficulties can seriously impair a tenant's logistics/supply chain operations.

Since a warehouse operation is critical to a company's supply chain efficiency, a decision to rent a warehouse space from a landlord becomes a partnership decision that will likely endure for many years. Therefore, a lessee should focus on the strength and reputation of the landlord as much or more than the commercial improvements that may be achieved during a crisis period.

Those other benefits include better quality premises, superior locations, optimized transport accessibility, better service quality and higher technical specification. But we would argue these should be considered within the context of reasonable improvements to commercial terms with a strong landlord. Put another way, when a landlord price-dumps it is a clear sign of desperation and a desperate landlord is a very risky partner. Therefore decisions made today will have big implications tomorrow.

The overall picture shows that the market will reach its bottom by the middle of the 2015. But main features of the quality supply would be comparatively stable price rates especially in long-term contracts and considerably lower vacancy rate. So taking into consideration the average half-year period of the contract execution now is exactly the window of opportunities for the tenants.

No matter what would be the decision to follow these opportunities: to optimize logistics through relocation, to move to the high-grade logistics park, lease or "built-to-suit" new premises, current conditions allow to draw more advantages by choosing better options for the future growth of the company, i.e. to receive the best value for money in the long-term perspective.



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