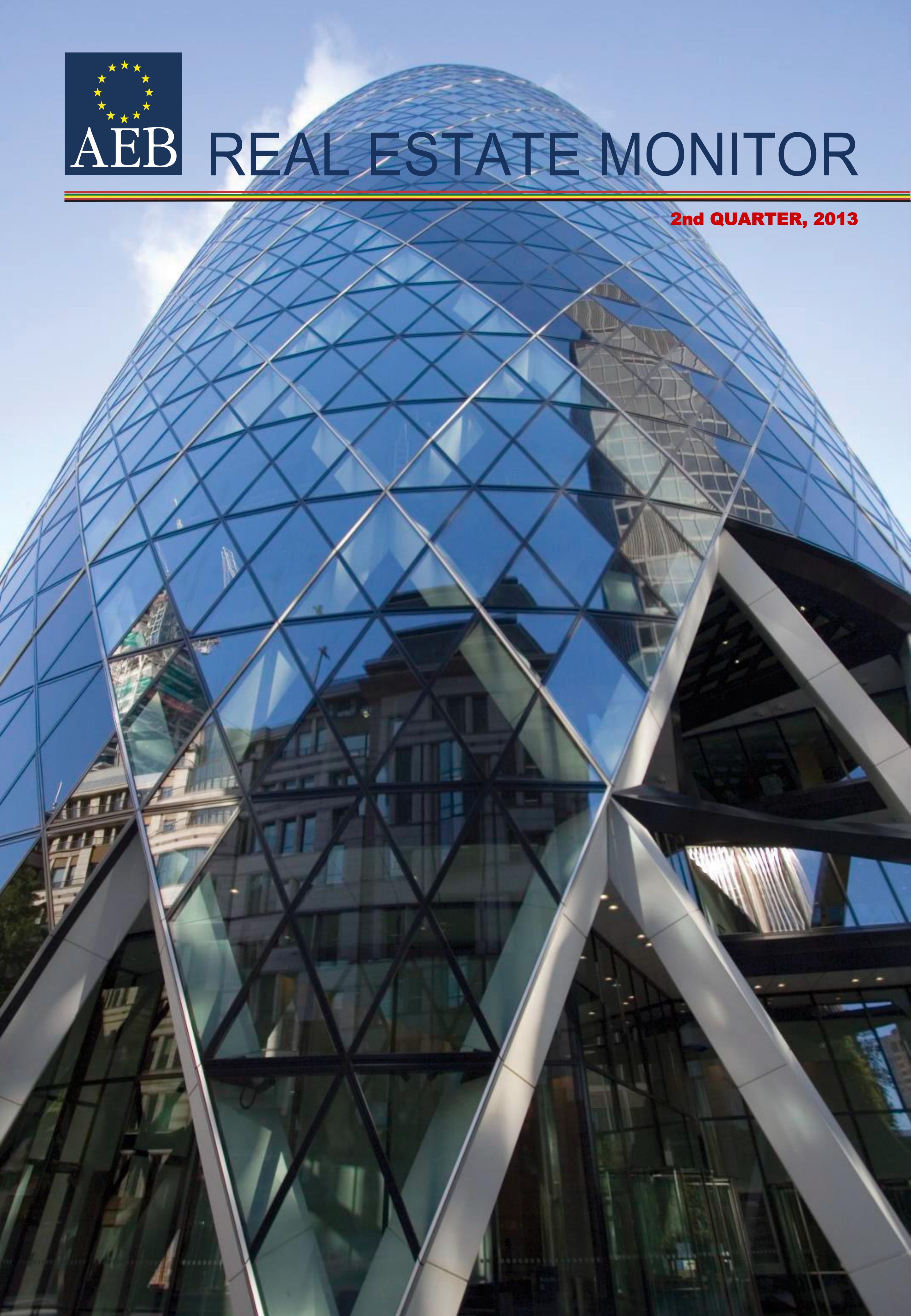
AEB

REAL ESTATE MONITOR

2nd QUARTER, 2013



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Letter from the Chief Executive Officer

Dear readers,

Welcome to the second quarterly edition of Real Estate Monitor!

The Association of European Businesses' Real Estate Committee continues to monitor the real estate sector of the Russian economy. In spite of weakening external demand and uncertainty over the economic environment, the mood of investors is optimistic. New projects are being launched and new space coming onto the market. During the last few months, Russia has seen an increase in real estate investment. The historical peak by transaction has been reached. But generally in 2013 investment activity is expected to be slightly weaker than in 2012, though that doesn't make the Russian market less attractive to foreign capital.

This issue of the Real Estate Monitor will give you an insight into the latest trends in the Russian market. The best experts will share their views and give analysis of the current situation. With a focus on Moscow and St. Petersburg, this issue will cover the retail, industrial, office market performance in terms of rates and yields.

I hope you will find a lot of useful information in this edition of the Monitor, and that it will help your business thrive.

Frank Schauff,
Chief Executive Officer
Association of European Businesses

Letter from the Chairman of the AEB Real Estate Committee

Dear Real Estate Practitioners,

Another edition of the Real Estate Monitor for Q2, 2013 has been collated and is ready for your reading.

Let me give you a short summary of the key elements of this edition.

Russian real estate investment demonstrated historical high result again: total transaction volume amounted to USD2.0bn, up by 104% compared to Q1 2012. After astonishing 2011-2012 results, this year is set to be slightly weaker in terms of investment volume, with annual figure expected at around USD7.5 bn, because of lack of products. Investments were still concentrated in retail and offices, accounting for 57% and 37% respectively. Retail sector vast domination was mainly a result of Metropolis shopping centre deal closure.

In 2013 investor interest will again be concentrated on core assets on Moscow office market. Logistics and retail are becoming strong competitors. Logistics is a sector of great interest with huge potential for acquisitions by occupiers, with the share of investment volume expected this year to remain at the level of 7% seen in 2012 or even approaching the global level of about 10-12%. Although foreigners made the market in Q1 2013, with 87% share (mainly Metropolis deal), domestic investors is still dominating, accounting for 67% in the last 12-month period compared to 58% in 2011.

In the office sector, first quarter started strong with 260,000 sq m of new supply added to the market. First time in three years we expect the level of annual new completions to exceed 1m sq m. Moscow corporate real estate decisions continued to be driven mostly by cost sensitivity, thus occupiers remain attracted more by the lower-cost decentralized space. Decentralized properties continue to attract the majority of demand with an 80% share of total recorded transactions. Despite the high level of deliveries vacancy rate posted a very marginal increase. As costs are still a prominent issue for most occupiers in 2013 we expect real estate decisions to be driven by location preferences and the rents tenants are able to negotiate among competing properties. Current office trends will intensify with occupiers favoring decentralized locations seeking both high-quality and efficient premises at reasonable costs.

On the retail market, Moscow saw no new deliveries in the first quarter of 2013. On the opposite, active development of retail projects in St. Petersburg and other regional cities intensified at the begging of the year, with some 300,000 sq m of new completions entering the market. This trend will continue in the following months with another 3,5m in the pipeline (announced projects by 2014), of which Moscow Region will account for 600,000 sq m. International brands keep targeting Russian market with plans of several international brands to enter and expand in Russia. We saw several chains taking the decision to buy out their business from franchisees and manage them directly. The “diversification” trend continued with the debut of theme parks likely to become an important trend on the market in 2013. Pedestrian zones development will give a positive impact on street retail development in Moscow.

In Q1 2013 Russian warehouse market remained attractive for developers and several new projects were announced. Completion volume kept increasing, about 100,000 sq m were delivered to the market (100% YoY). Despite increased completion the volume of available spaces did not rise significantly, as almost all new projects were pre-let or sold before the end of construction. Looking forward, future demand is strong with 2.5m sq m of announced projects for next 2 years. Build-to suits schemes remained popular with their share expected to account for almost 60% of 2013 completion. Decentralization was also taking place in the industrial sector with more projects on and beyond the “Betonka” (A-107). We expect this growth in supply to lead in fluctuations in vacancy rate, although market continues to be in deficit.

And please do not forget to attend our forthcoming events and our General Committee meetings. Your participation is of great interest and help and is needed to make this AEB Real estate Committee a success.

Best regards,

Past & Upcoming Events

Past events

- 18.03.2013 Open event – What will influence the Real Estate Market in Moscow in 2013 and beyond?
- 25.04.2013 Open event – Green Building: from Theory to Practice.
- 24.05.2013 Steering Group meeting. Venue: Jones Lang LaSalle
- 11.06.2013 General Committee meeting. Venue: Kinnarps

Upcoming events

- 01.09.2013 Deadline for submissions for Q3 Real Estate Monitor
- 19.09.2013 Open event on the challenges of tenants/occupiers within their offices
- 11.2013 (tbc) Open event on Green Building
- 12.2013 (tbc) Open event on Real Estate market

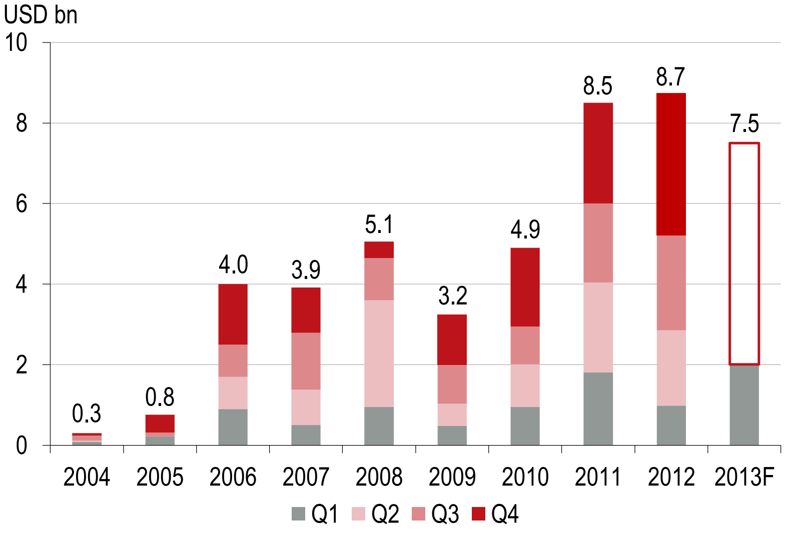
Real Estate Quarterly Market Snapshot Review

Investment Overview

Total investment volume in Russia reached USD2.0bn in Q1 2013, up 104% compared with Q1 2012, according to Jones Lang LaSalle analysts. As a result, a record high volume has been registered in Q1 2013 compared to the first quarters of previous years. This was mainly a result of Metropolis shopping centre deal closure.

Several large deals, which were postponed from Q4 2012, were allowed a good start and enabled us to set a new record. The closure of some more large deals is expected this year. Diversification among sectors is still the rule and every sector has deals under active marketing or negotiation.

Russian Real Estate Investment Volume Dynamics, USD bn*



•*Investment deals, excluding land purchases, JVs, direct residential sales to end-users*

The sale of Metropolis shopping centre has significantly changed the overall characteristics of the market.

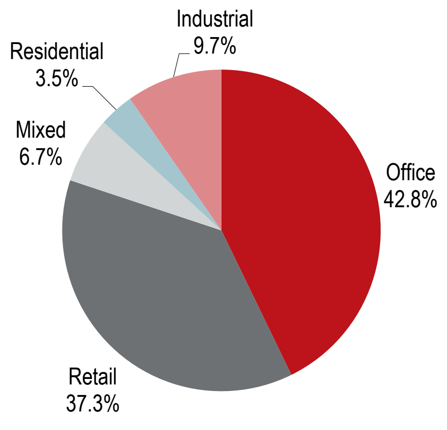
Historically investment into offices dominated the market. The situation has changed in Q1 2013 – real estate investments were concentrated in retail, accounting for 57%, compared to 37% in Q1 2012. While office investment accounted for 37% compared to 43% in Q1 2012.

Source: Jones Lang LaSalle

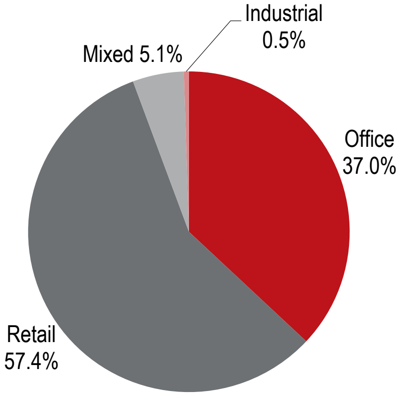
Real Estate Quarterly Market Snapshot Review

Total investments by real estate sector

Q1 2012



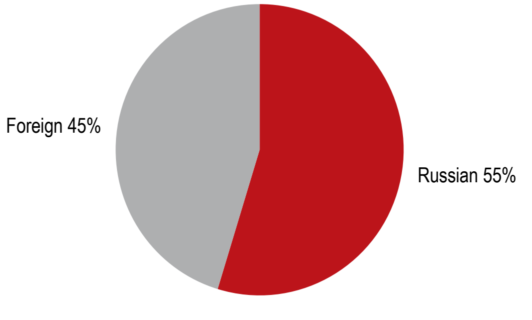
Q1 2013



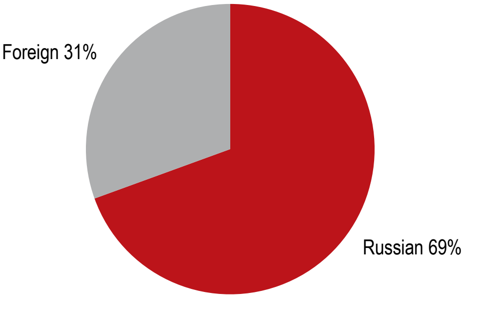
Thus, Russian investments were even more concentrated in Moscow in Q1 2013, accounting for 96% of total deal volume vs 87% in Q1 2012. Traditional domestic capital domination changed to foreign in Q1 2013, with their share being at 87% compared to 6% in Q1 2012. But if we exclude the skew effect of Metropolis deal, the share of local to foreign investors will be 76% to 24% respectively for the last 12 months.

Real estate investors by source of capital

2007-2011



2012-Q1 2013



Cyprus's financial issues has been one of the most significant events recently. We saw that some companies already began shifting into other offshore territories. However, current legislation changes do not foresee any changes in the double tax treaty, thus many will prefer to stay in Cyprus to avoid costs of transferring to other territories, as well as continuing in a well-known legal and deal structure. We believe, this situation will not have negative effect on the investment market and confirm our previous forecast for this year at USD7.5bn.

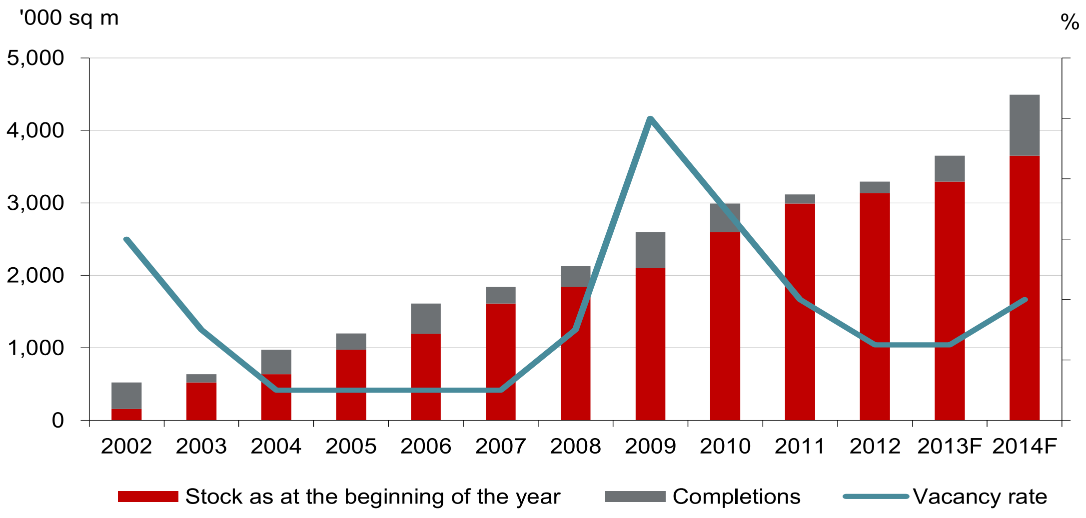
Source: Jones Lang LaSalle

Real Estate Quarterly Market Snapshot Review

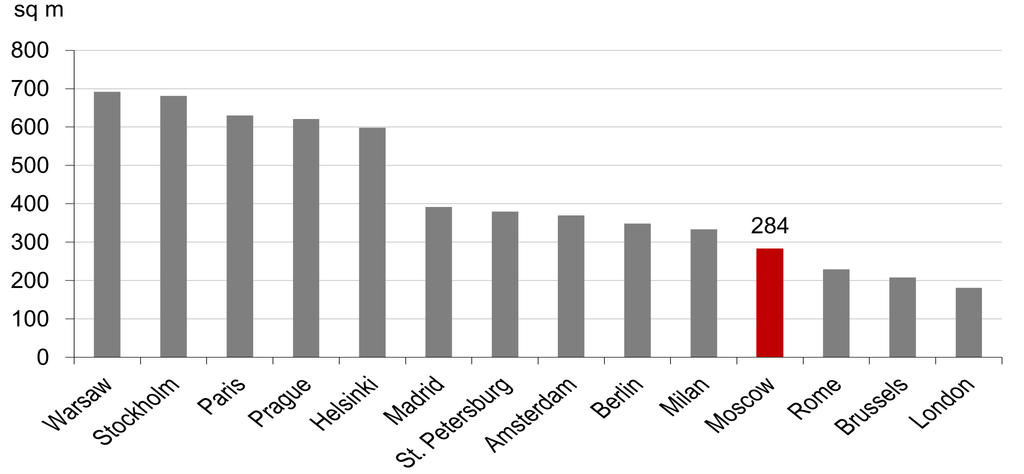
Retail Overview

Russian retail real estate market received 300,000 sq m of new quality premises in Q1 2013. Total quality stock in Russia exceeded 14.5 m sq m in Q1 2013. There were no new deliveries in Moscow in Q1 2013. Total quality stock in Moscow remained at the same level of 3,295 thousand sq m of GLA. Active development of retail projects in the Moscow Region is an important trend. By the end of 2014 the market is likely to be supplied with more than 600,000 sq m of quality premises (announced completions) which demonstrates a trend of growing completions (less than 200,000 sq m in 2012 and less than 100,000 sq m in 2011). Krasny Kit shopping centre (phase II) in Mytischi and Komsomolets shopping centre in Krasnogorsk are among major pipeline projects.

Moscow Market Balance



Stock per 1,000 Inhabitants



Source: Jones Lang LaSalle

Real Estate Quarterly Market Snapshot Review

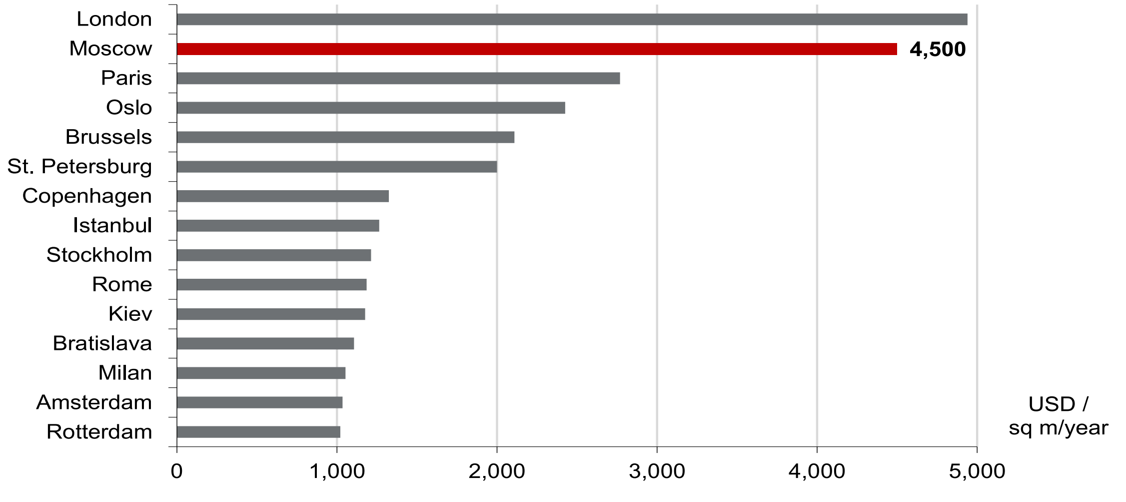
Key macroeconomic figures demonstrate the growth of the Russian economy. Retailers continue to show significant interest in Russia taking account of positive dynamics of macroeconomic indicators. Several foreign retailers targeted the Russian market in Q1 2013. Marukame and Lavazza Espression opened their first cafes, Trollbeads opened its first jewellery stand in Atrium shopping centre, Herve Leger opened its first fashion monobrand store.

In 2013 several brands are likely to enter the Russian market. Restaurant chains Quiznos, Nando's and Cheesecake factory are among them. Global Franchise Group plans to launch three restaurant brands – Marble Slab, Great American Cookies and Pretzelmaker. Takko Fashion, Blue and Nautica are among the most prominent potential fashion newcomers. Several chains took the decision to buy out their business from franchisees. For instance, Cortefiel Group bought out Springfield and Women'secret from its Russian partner, Melon Fashion Group and intends to manage both brands directly. Moreover the Spanish retailer is considering the return of the Cortefiel brand to the Russian market.

Many well-established (both Russian and international) brands continue to expand their chains in Moscow and on the regional markets.

Average rental rates and leasing terms remained level in Q1 2013. Prime rents were USD3,000–4,500/sq m/year and average rents were USD500–1,800/sq m/year. The vacancy rate remained stable at the very low level of 2.5%. Moscow ranks 2nd after London in the list of key European markets with highest rental rates.

European prime SC rents



Shopping centre construction is expanding beyond Moscow and St. Petersburg. Developers continue regional expansion – 66% of the pipeline for 2013–2014 is planned for regional cities. Furthermore, 46% of the pipeline for 2013–2014 is planned for cities with a population of less than 1m people. This will enable Russian and foreign retailers to strengthen their positions on the market and continue expanding in the regions.

The announced pipeline for Moscow for 2013–2014 exceeds 1m sq m. At the same time it is common for a number of projects to be postponed. However, even if all the pipeline projects are completed on time the 'stock per 1,000 inhabitants' figure will increase by 11% (314 sq m per 1,000 inhabitants) which is still below the levels of most large European cities.

The debut of theme parks is likely to become a major trend of 2013. Global brand DreamWorks will be developed by Regions group of companies, Moneks Trading will manage Kidzania and Finnish Rovio plans to open an Angry Birds theme park.

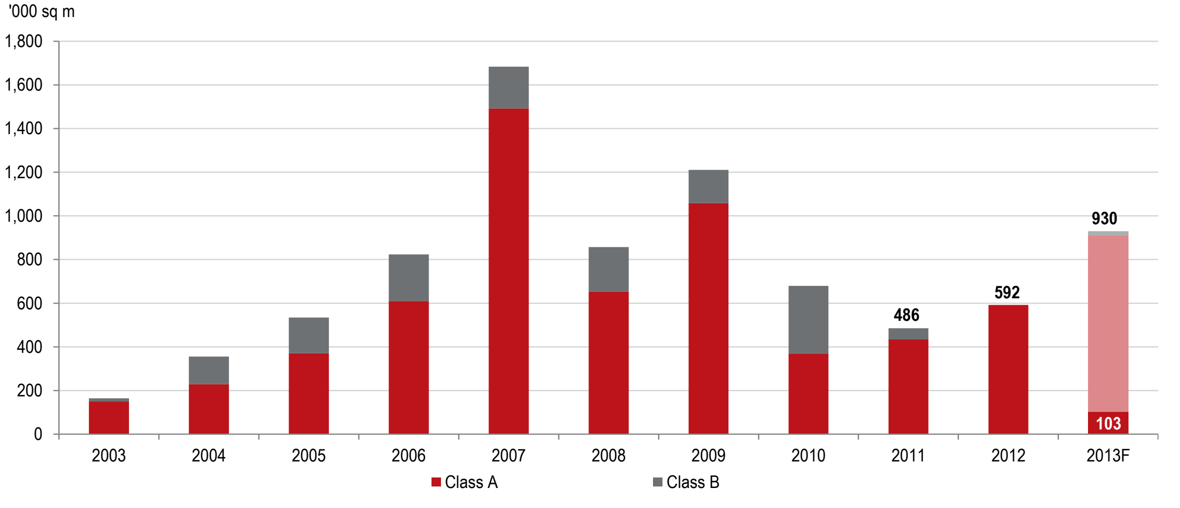
Source: Jones Lang LaSalle

Real Estate Quarterly Market Snapshot Review

Industrial overview

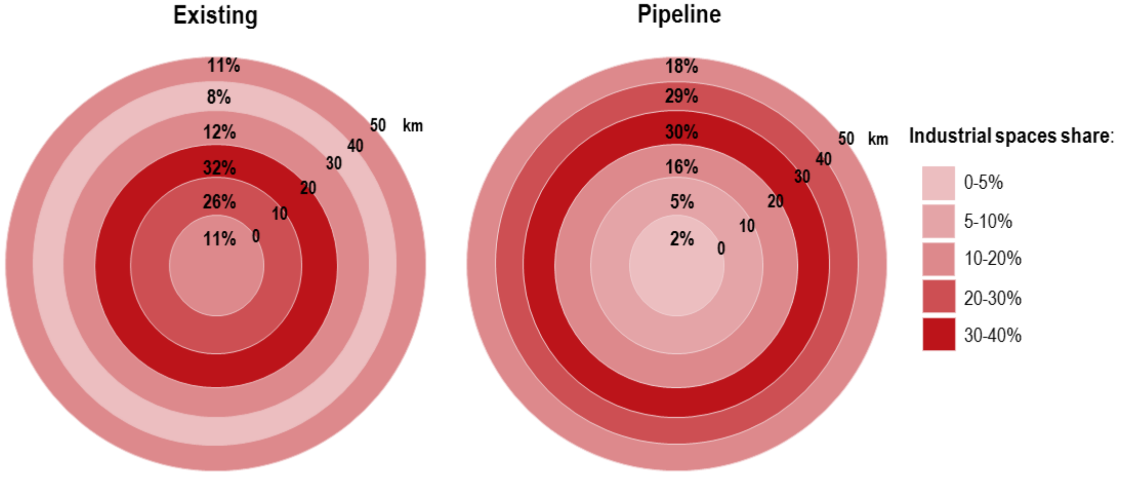
In Q1 2013 new completion volume kept increasing: about 100,000 sq m was delivered to the market, which is 100% growth on YoY basis. Despite increased completion the volume of vacant spaces did not rise considerably, as almost all new projects were pre-let or sold before completion. Total expected for 2013 projects account for 930,000 sq m it is more than 50% YoY growth.

Supply dynamics



Key trend in Moscow warehouse market is new projects decentralization. Majority of existing projects is located within a radius of 20km from Moscow Automobile Ring Road. Recently established truck-weight restrictions force developers to locate projects on A-107 and upcoming Moscow Central Ring Road (20-40km from MKAD).

Distribution of warehouse by distance from Moscow Ring Road

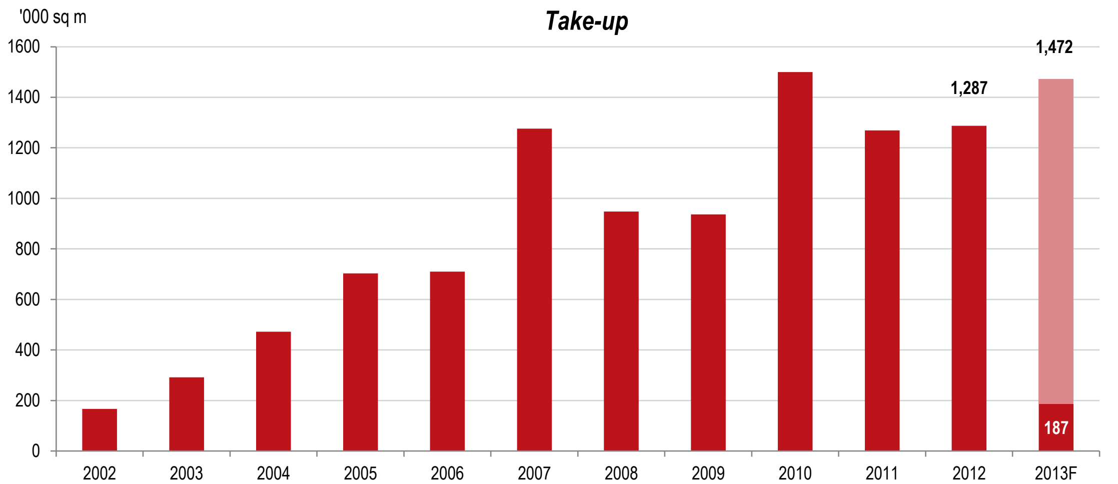


Source: Jones Lang LaSalle

Real Estate Quarterly Market Snapshot Review

On the other hand pipeline is divided between two key directions, North and South. This is largely because of good transport access, existing in the south (M-4 – Kashirskoe Highway, M-2 – Semfiropolskoe Highway) and under construction in the north (new Moscow-St. Petersburg road). Next phases of PNK-Chekhov (312,000 sq m) and South Gate (233,000 sq m) projects in the south are among the key projects of 2013-2014 There are several new big projects in the north, starting from Logopark Sever (110,000 sq m) planned to be delivered in Q2 2013, Nikolskoe LP (106,000 sq m) and Dmitrov LP II (63,000 sq m) – in Q1-Q2 2014, to Radumlya LP and PNK-North – during 2014-2015. This variety of projects gives a wide choice for potential tenants and encourages developers to pre-lease or pre-sell projects before start of construction, in order to minimize competition.

Demand for industrial real estate in Moscow region remained stable with take-up amounted to 190,000 sq m in Q1 2013 (12% YoY drop). Main drivers of the demand activity remained retailers and distribution companies (about 66% of total demand). More than 30% of demand activity was carried up by e-commerce, multi-channel retailers and IT distributors. We expect total demand of 1.5m sq m by the year end with the increasing sales share approaching 1/3 of annual take-up. In 2012 it was about 26% and in 2011 only 10%.

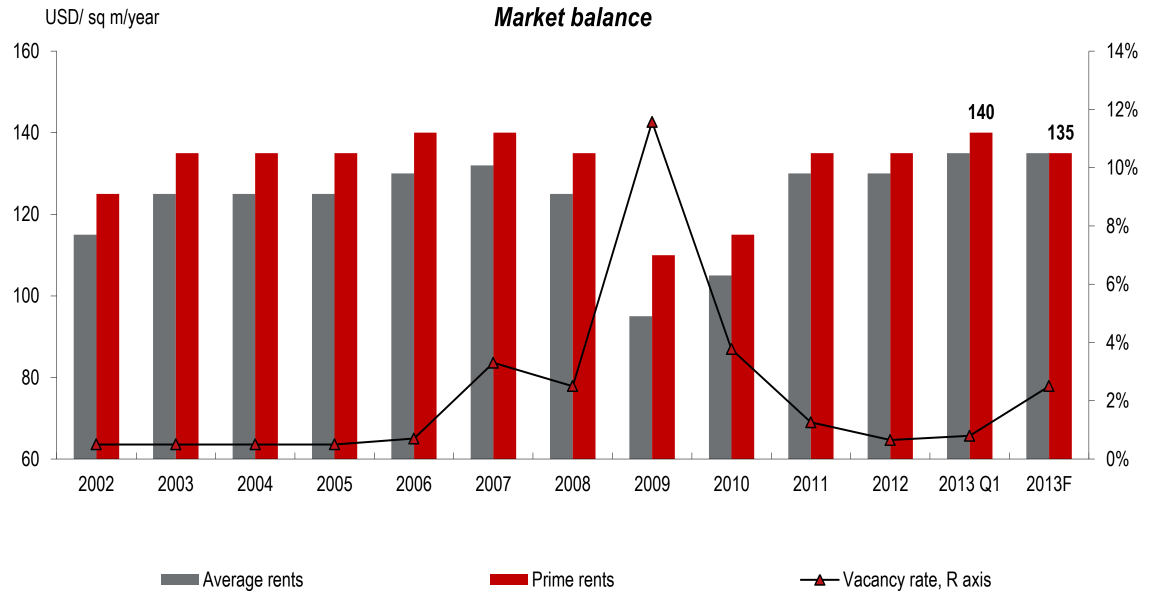


There is still a deficit of warehouse space in the market and the vacancy rate remains negligible at 1.07%. Almost all new completions were fully let or sold before the end of construction, thereby not influencing availability. Occupiers requirements for large premises (more than 10,000 sq m) can only be fulfilled by pre-leases (usually 6-8 months before completion) or build-to-suit contracts. We expect the same situation over 2013, the vacancy rate could fluctuate slightly, yet not exceeding 2.5-3%.

We estimate current prime rents on level of USD140/sq m/year. Anyway there are almost no available areas, the current market is a market of 'future projects' and average rent for BTS project or early prelease is lower, USD130-135/sq m/year. Large amount of projects are announced for 2013-2014, but developers prefer to wait occupiers in order to start construction, so supply is growing only in response of demand and we expect commercial terms to remain approximately the same by year end.

Source: Jones Lang LaSalle

Real Estate Quarterly Market Snapshot Review



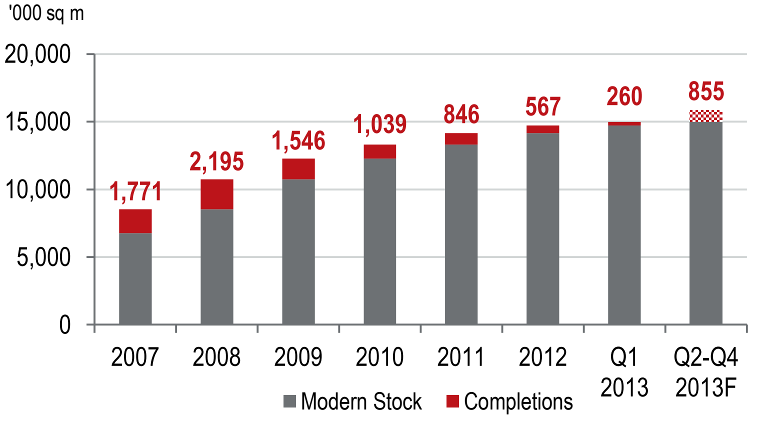
Source: Jones Lang LaSalle

Real Estate Quarterly Market Snapshot Review

Office overview

First quarter of the year was marked by a high level of completions of 260,000 sq m that entered the market, a 113% increase on a YoY basis. Out of 13 buildings completed, two of them are Class A and they accounted for 30% share of total new supply: White Gardens Office Center (office area – 63,900 sq m) and Rosso Riva (11,947 sq m). In terms of pipeline, first time in three years, the level of annual new completions is expected to exceed 1m sq m. High quality developments include: Mercury City, Wall Street, Country Park (phase III) and Riga Land (Phase II, Block A).

Supply dynamics

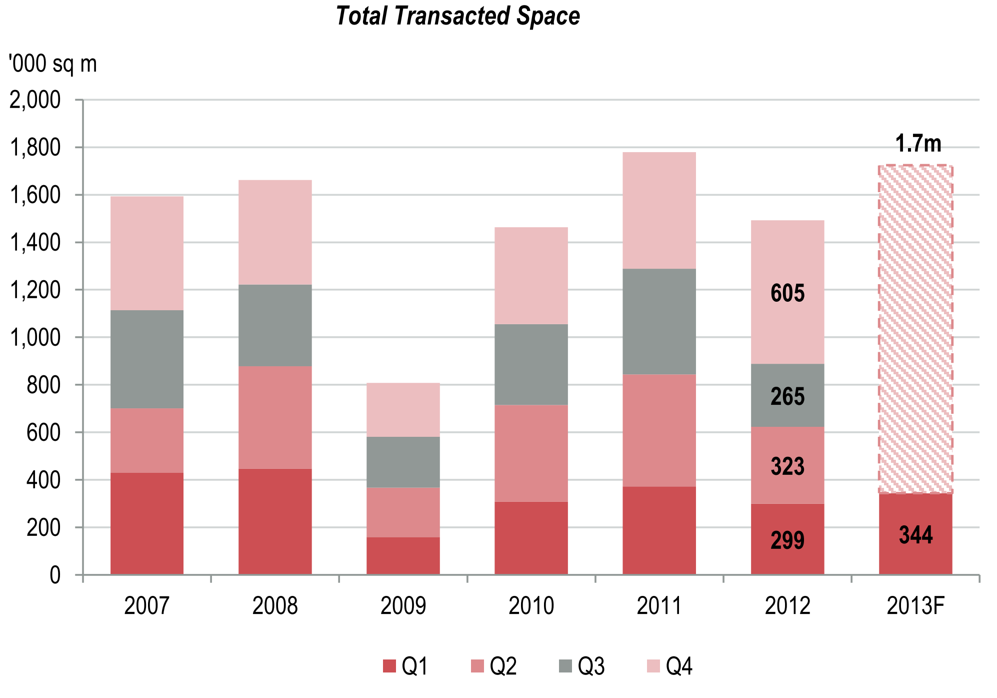


Occupier activity in Q1 was active as well and amounted to a healthy 344,440 sq m, of which 80% was transacted further away from the CBD. At the beginning of the year Moscow corporate real estate decisions continue to be driven mostly by cost sensitivity, thus occupiers remain attracted more by the lower-cost decentralized space. Moreover, as companies are looking for efficient, modern space configurations, they are opting to relocate to newer, higher quality buildings in order to achieve the efficiencies they seek. In Q1, 90% of all take-up was executed in A and B+ Class premises.

Demand was driven by the Mining & Exploration (26%), Manufacturing (24%) and Business Services (22%) sectors. Largest transaction of Q1 was the lease by Gazprom in Varshavka Sky (24,000 sq m).

Source: Jones Lang LaSalle

Real Estate Quarterly Market Snapshot Review

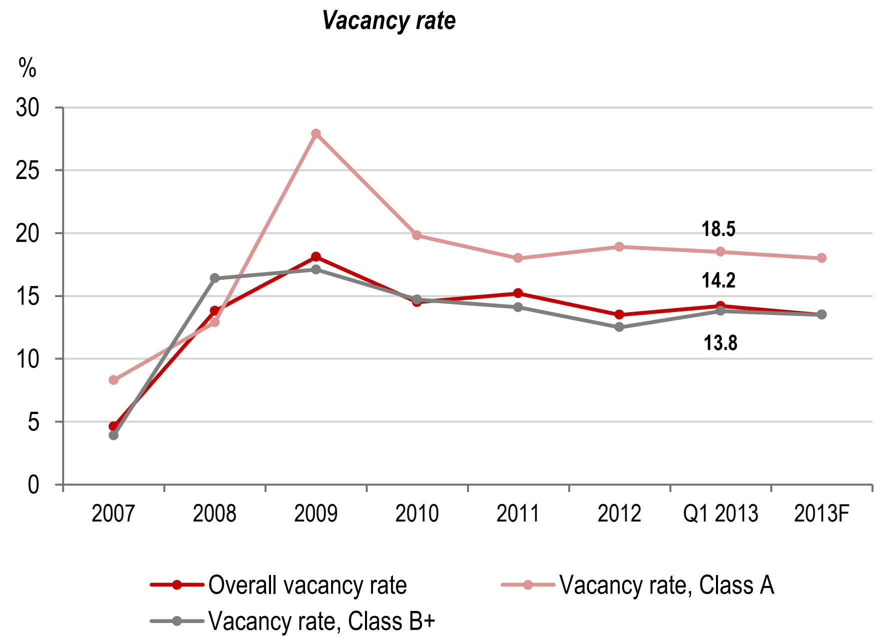


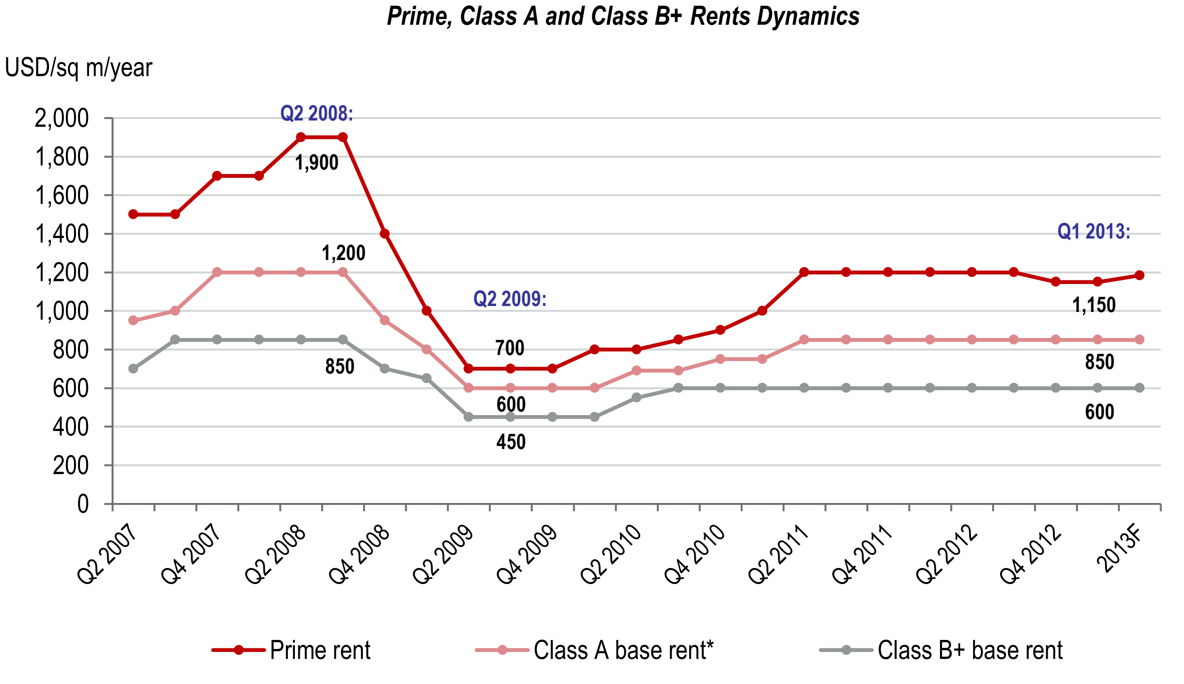
Out of all modern office stock in Moscow (14.9m sq m) some 2.1m sq m is available, of which 520,000 sq m is Class A. In terms of location, the largest opportunities are to be found in the Garden Ring to MKAD submarket (1.6m sq m); 400,000 sq m is in CBD, while Moscow City financial district has 85,000 sq m available. Despite the high level of deliveries vacancy rate posted a very marginal increase. In the first quarter of this year this level was recorded at 14.2% (last quarter the level reached 13.5%). Class A vacancy rate amounted to 18.5%, whereas Class B+ vacancy rate reached 13.8%. This suggests that pre-leases are returning and is a positive trend in the market.

Prime rents in Q1 remained unchanged at the level of USD1,000 to USD1,150/sq m per year. CBD Class A rents were recorded at USD650–1,150. Moscow City represents a growing opportunity for occupiers with rents varying from USD650–950. Attention to cost is increasingly driving tenants towards lower-cost outside the CBD space. In this respect, decentralized locations (TTR to MKAD) displayed the most attractive rents with USD450–700 for Class A premises.

Source: Jones Lang LaSalle

Real Estate Quarterly Market Snapshot Review





Source: Jones Lang LaSalle

Real Estate Quarterly Market Snapshot Review

As costs are still a prominent issue for most occupiers in 2013 we expect real estate decisions to be driven by location preferences and the rents tenants are able to negotiate among competing properties. Current office trends will intensify with occupiers favoring decentralized locations seeking both high-quality and efficient premises at reasonable costs.

Demand is expected to remain strong and reach 1.7m sq m by the end of 2013, with leasing activity driven more by Russian companies. Market will remain stable throughout the year with a total vacancy of 13.5% forecasted at the end of 2013. Rents in prime areas are likely to see a modest growth, while across all Classes they are expected to remain flat.

From the pipeline prospective, a deficit of new supply is estimated in prime locations. Until the end of 2015 we expect another 3m sq m to be delivered to the market. Of this, half is expected to be Class A premises and more than two thirds located outside of the current prime locations. Notable high quality developments including six skyscrape schemes in Moscow City financial district (office area - 615,000 sq m) and nine decentralized business parks schemes (office area - 770,000 sq m). Driven by cost-optimization, these two submarkets offer occupiers not only high-quality space and large floor plates, but also attractive rents, which cannot be achieved in CBD.

Source: Jones Lang LaSalle

Real Estate Quarterly Market Snapshot Review

Moscow Hospitality Overview

Operational indicators across all segments of Moscow hotels for the period from January to April 2013 demonstrated a decrease compared to the same period in 2012. Thus, average occupancy across all market segments of Moscow hotels decreased by 2% and comprised 63%. Average daily rate (ADR) demonstrated a decrease on 3% amounting to 256 US Dollars. A 7% decrease of RevPar (revenue per available room) was registered as of May 2013 and amounted to 159 US Dollars.

The upscale segment demonstrated a decrease of all operating indicators. The occupancy decreased by 3% compared to the first four months of 2012 and comprised 59%. Average daily rate (ADR) remained almost unchanged demonstrating a slight 1% decrease and comprised 366 US Dollars. Revenue per available room (RevPar) decreased by 6% and amounted to 217 US Dollars.

Business hotels did not demonstrate better results in January – April 2013 than in the same period in 2012. RevPar (revenue per available room) of business hotels decreased by 8% (144 US Dollars) which was the result of a 2% occupancy decrease (65%) and a 5% ADR (average daily rate) decrease (221 US Dollars).

The operating indicators of midscale hotels also showed decrease compared to the first four months of 2012. Thus, an overall occupancy decreased by 2% and comprised 64%. Average daily rate (ADR) as well as RevPar (revenue per available room) demonstrated a negative trend: ADR decreased by 5% (182 US Dollars) and RevPar decreased by 8% (16 US Dollars).

An absolute gap in RevPar between the segments in January – April 2013 remained almost unchanged compared to the same period in 2012 and demonstrated the following results:

- The variation between the upscale and midscale segment comprised 101 US Dollars (104 US Dollars in January – Aril 2012).
- The variation between upscale and business hotels comprised 73 US Dollars (74 US Dollars in January – Aril 2012).

During the 1st quarter of 2013 two hotels opened in Moscow. A five-star Nikolskaya Kempinski hotel on Nikolskaya Street, 12/1 opened in May (grand opening of the hotel is scheduled for the end of August/beginning of September). The hotel comprises 211 rooms (only 70 rooms are availiabe now), a restaurant, a lobby bar and five conference rooms. By the time of grand opening the rest of the room stock, several more restaurant and bars, a fitness-center, a SPA and a swimming pool will open at the hotel. Also a four-star Novotel Moscow City hotel located at Presnenskaya Embarkment, 2 opened in February. The hotel comprises 360 rooms, a restaurant, a bar, eight meeting rooms and a fitness center.

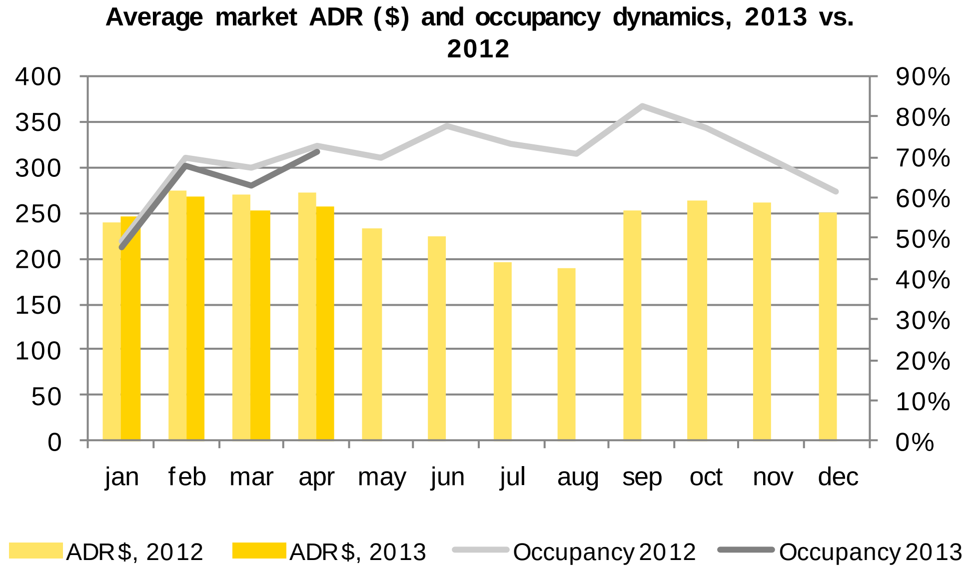
We believe that operating indicators will stabilize and start improving by the end of 2013. We also expect to see increase of existing hotel supply and resumption of postponed construction works on hotel projects.

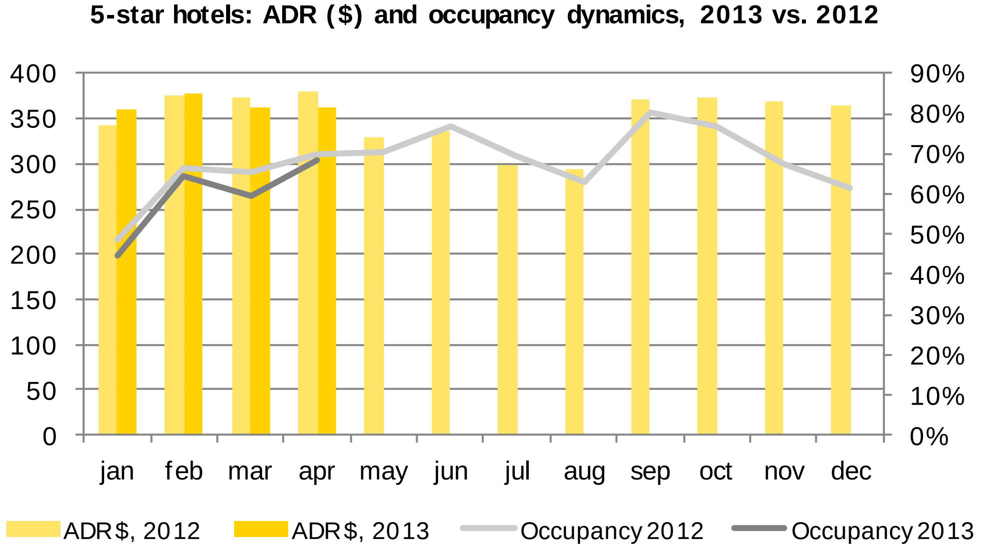
Future hotels announced for opening in 2013

Name	Room number	Address	Class
Marriott Novy Arbat	234	Novy Arbat Street, 32	5 stars
Sheraton Moscow Sheremetyevo	333	Mezhdynarodnoye Highway, 28	4 stars
Boutique hotel Pushkin	110	Tverskaya Street, 16/2	4 stars
Hilton Garden Inn New Riga	162	Novorizhskoe highway, west of Moscow	3 stars

Source: Ernst & Young database, open sources, operators' data

Real Estate Quarterly Market Snapshot Review





Source: Ernst & Young

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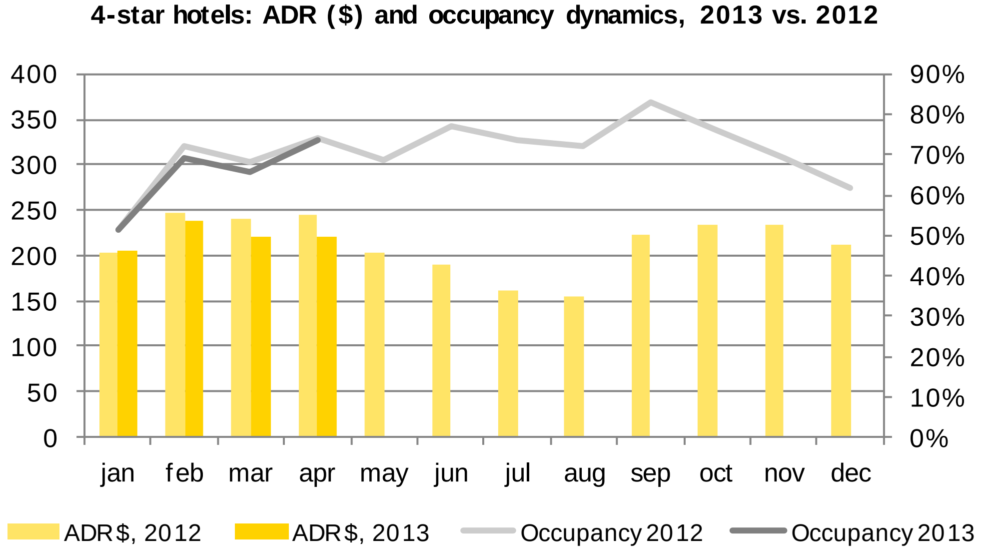
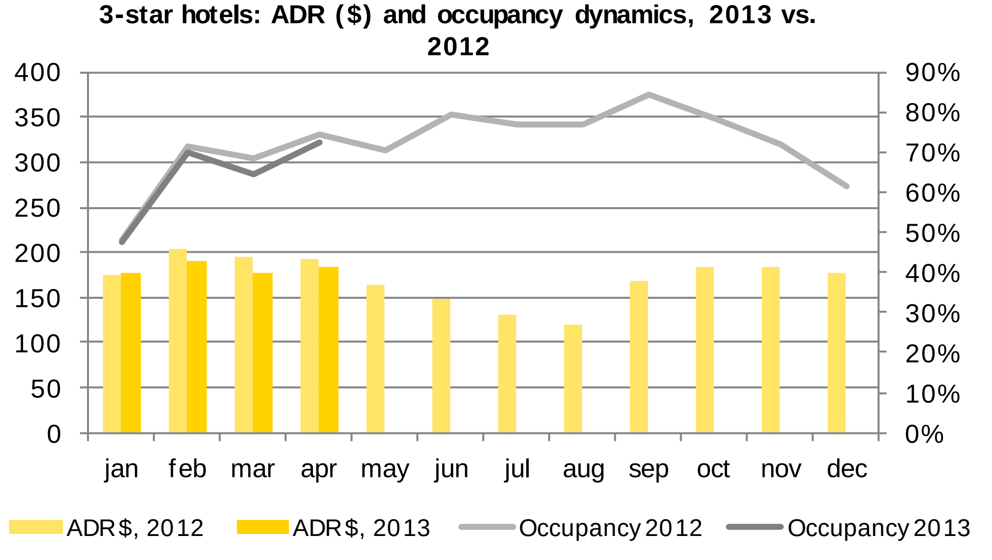




Source: Ernst & Young

Real Estate Quarterly Market Snapshot Review

Operational indices dynamics

	January - April 2013 (US Dollars)	January - April 2012 (US Dollars)	2012	January - April 2013 / January – April 2012, %	January - April 2013/ 2012, %
5 stars					
Occupancy	59%	63%	68%	-3%	-9%
Average daily rate (ADR)	366 $	368 $	350 $	-1%	4%
Revenue per available room (RevPAR)	217 $	231 $	246 $	-6%	-12%
4 stars					
Occupancy	65%	67%	71%	-2%	-6%
ADR	221 $	233 $	212 $	-5%	4%
RevPAR	144 $	157 $	150 $	-8%	-4%
3 stars					
Occupancy	64%	66%	72%	-2%	-8%
ADR	182 $	192 $	170 $	-5%	7%
RevPAR	116 $	127 $	122 $	-8%	-5%
Average					
Occupancy	63%	65%	70%	-2%	-8%
ADR	256 $	264 $	244 $	-3%	5%
RevPAR	159 $	172 $	172 $	-7%	-8%

Source: Ernst & Young, Smith Travel Research

Real Estate Quarterly Market Snapshot Review

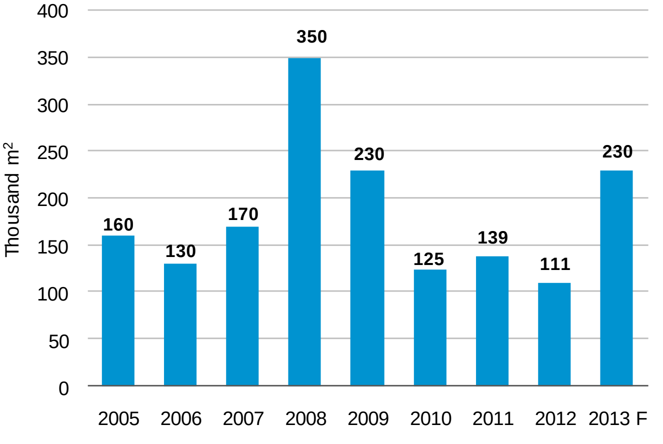
St. Petersburg - office market overview

2013 is expected to show the largest supply volume since 2009 when the market faced the results of construction boom started in 2005-2006. Demand volumes are quite close to pre-crisis levels, while rental rates do not show rapid growth due to high volumes of new office space delivered to St. Petersburg market.

Supply

St. Petersburg office market currently faces recovery in terms of new quality supply. As of the end of Q1 2013, the total existing stock amounted to 1.78mn sq m with Class A share at 30% of the stock. The major amount of new office space is expected to enter the market in spring-summer 2013, including such large-scale projects as: 'Nevskaya Ratusha' (1st phase), 'Leader Tower', 'Renaissance Pravda', and 'Renaissance Premium'. In total, according to developers and construction companies, there are about 40 Class A and Class B office buildings with total leasable area of 450,000 sq m under construction. More than a half of this volume is expected to be delivered in 2013.

Annual completions dynamics



The preferrable destinations for developers have not changed during last several years – the major share of new projects appear in CBD, and Moskovskiy District of St. Petersburg. The latter takes approximately 35% of the total future supply, whereas Central District forms 23% of the future supply.

Demand

The market witnessed stable demand growth in 2012, when take-up volume reached 187,000 sq m – the highest volume on the market since 2009. Gas&Oil sector and IT sector remain the key source of demand for office space. Banking and finance sector, as well as construction sector are gradually restoring after weak 2009-2010 years. However, their share in the total volume is still rather low (around 10% from the total volume of deals since the beginning of 2013). Tenants continue to improve their office space. There is a growing trend for lease deals in the segment 1,000–2,000 sq m.

High market activity forced vacancy rates to go down during last 12 months. Average market vacancy rate has dropped in 2012, despite the fact that a large amount of new office space was put into operation in H2 2012. This proves a growing activity of office tenants. In Q1 2013, the average vacancy rate reached 8.7% (vs. 12.8% in Q1 2012). As at the beginning of Q2 2013 vacant spaces in Class A and B office buildings accounted for nearly 155,000 sq m. Despite such high activity, temporary vacancy rates increase in expected in H2 2013, when large Class A/B+ office buildings will be delivered to the St. Petersburg market.

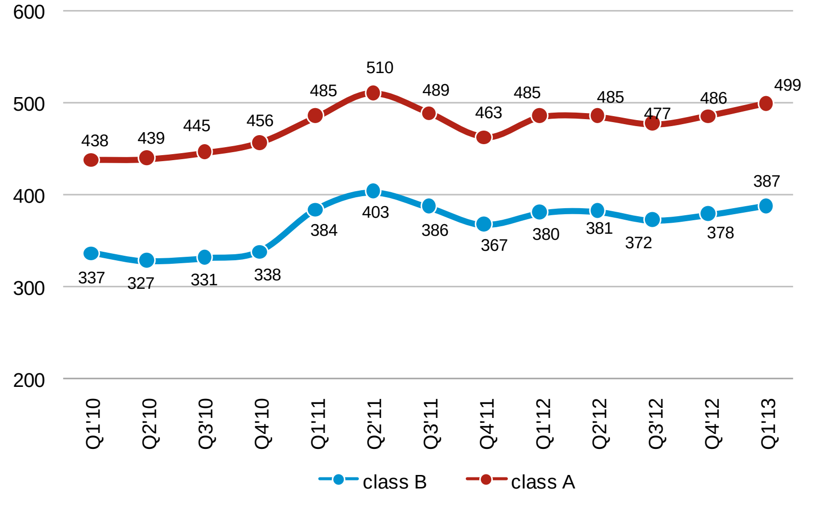
Source: AEB North-Western Regional Committee, Construction and Real Estate sub-committee

Real Estate Quarterly Market Snapshot Review

Rental rates and commercial terms

High tenants' activity on the office market did not influence rental rates seriously. 2012 saw average growth of rental rates in Classes A & B, on average by 4-5% in ruble terms. The average market asking rental rates at the beginning of Q2 2013 amounted to 1,263 Rubles per sq m/month ($498 sq m/year), including OPEX, net of VAT, in Class A; 980 Rubles per sq m/month ($387 sq m/year), including OPEX, net of VAT, in Class B.

Rental rates dynamics (USD/sq m/year)



Shell&core office can hardly find its tenants, so during last several years landlords have changed their approach according to the tenants' needs. Office space in newly built office buildings is usually offered fitted-out. For large tenants that have specific requirements for office space planning and decoration, landlords offer fit-out compensation in the range $150-250 /sq m depending on the project. This sum is returned to the tenant as a rental discount for the first year of leasing period.

Trends and forecasts

- It is expected that the new office stock in 2013 will reach the maximum level on the 'after-crisis' market. We forecast the take-up volume at max 200,000 sq m in 2013, therefore a slight growth of the average market vacancy rate (up to 11%) is expected in H2 2013.
- Average ruble rental rates are expected to remain stable in 2013, despite the fact that large amount of new office space is expected to enter the market. This is explained by the current lack of quality office premises in the city and a high level of asking rental rates for the new Class A properties which are planned to be put into operation in 2013.

Source: AEB North-Western Regional Committee, Construction and Real Estate sub-committee

Real Estate Quarterly Market Snapshot Review

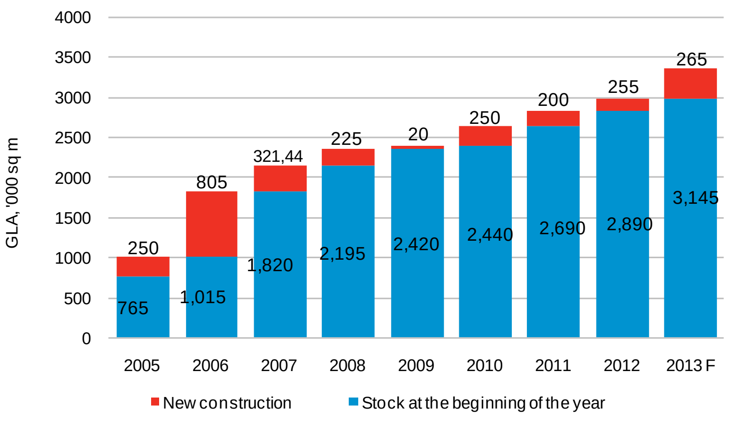
St. Petersburg - retail (shopping centers) market overview

Shopping centres comprise around 74% of the total existing retail stock. Hypermarkets and DIY centers take 20% of the market, while furniture centers form 65 of the total stock. High supply level on one hand, and limited demand from fashion retailers on the other hand result in rental rates stability.

Supply

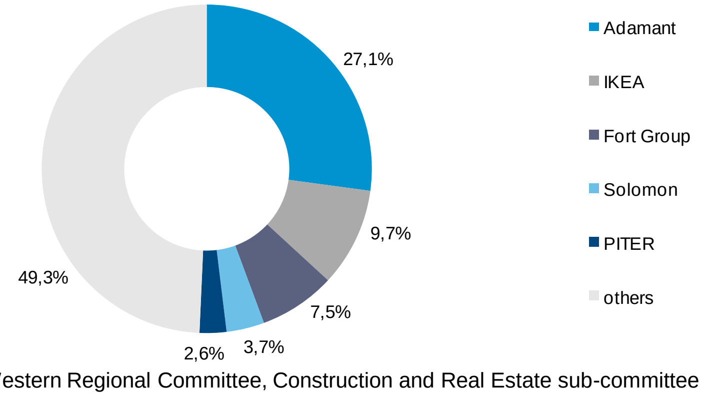
Shopping center market remains one of the most actively developed sectors of commercial real estate in St. Petersburg. Showing one of the highest shopping centers provision figures among Russian cites (465 sq m per 1'000 inhabitants) the city still can offer over 15 shopping centers in the pipeline for new and existing retailers. Shopping center pipeline for summer – winter 2013 remains high with nine projects totaling around 250,000 sq m of leasable space under construction. Thus, the total shopping center stock in St. Petersburg should reach 2.5mn sq m of leasable retail space by the year-end.

Total stock and new construction dynamics (total retail stock)



Current market leader in terms of development is local player, Adamant company. Its share in the total existing shopping centre stock amounts to 27.1%. Another active developer is Fort Group Company with 7.5% of the stock. Fort Group will strengthen its position in the nearest two years, as soon as several large-scale projects developed by this company will be completed. The only foreign player in Top-3 is IKEA MOS with two superregional shopping centers and market share at 9.7%.

Key retail market players (by GLA of existing shopping centers)



Source: AEB North-Western Regional Committee, Construction and Real Estate sub-committee

Real Estate Quarterly Market Snapshot Review

In terms of geographical distribution of existing stock, Primorsky, Vyborgsky, Moskovsky still lead in terms of space, accounting for 50% of the existing shopping centres. These districts also have the highest shopping centers provision indicators.

Demand

Demand on premises in qualitative shopping centers remains at rather high level. Occupancy of newly shopping centers with professional concept before opening is not less than 85%. As previously, demand is driven mainly by food retailers, as well as fashion gallery tenants and catering operators of medium price segments.

Fashion-operators prefer opening outlets only in large retail schemes with GLA over 35,000-40,000 sq m. Major fashion-operators (Inditex, Marks&Spencer, H&M) have limited development plans and carefully chose projects. Preference is given to regional shopping centers with good location and professional commercial and architectural concept. At the same time, some fashion-operators (Kiabi, Takko, Uniqlo) and large Moscow restaurateurs not presenting on St. Petersburg market are in the process of active negotiations with developers of shopping centers and intend to open their first outlets within the nearest two years.

One of the key trends observed in the last couple of years is changing entertainment format presented in shopping centers. Entertainment centers of Arcada format are gradually losing popularity. Theme parks, such as Happylon, Dino Park, are still in demand, though the vector of attention is moving towards entertainment centers that can offer educational format for young visitors. This started with middle-size entertainment centers such as Umnikum and LabirintUm. However, the latest projects of this format became much larger reaching 4,000 – 5,000 sq m. Examples of such projects are Kidburg, Mastergrad and Minopolis,

Rental rates and commercial terms

Average rental rates growth in shopping centers was within 3-10% in 2012 (due to indexation). Larger rental increase was observed only in café&restaurants segment, and grocery stores segment, as competition for space in these segments remains one of the highest. Unique retail projects in the city might get higher rents than the market average, but there are only few examples of higher rents than the average. Rents for fashion and apparel retailers remained stable throughout last two years.

Developers increasingly use a mixed system of rents payments, when a tenant pays a fixed rental rate or percentage from the turnover, depending on which sum is higher.

Trends and forecasts

- New quality retail schemes will attract new tenants to the city.
- Intensified market competition will lead to reconception of neighborhood and community shopping centers located close to each other.
- Fashion operators will continue their current restricted expansion policy, paying attention to outstanding schemes, which in turn will lead to a certain transformation of shopping centers concepts: restaurants and services will be gradually replacing fashion operators.

Source: AEB North-Western Regional Committee, Construction and Real Estate sub-committee

Real Estate Quarterly Market Snapshot Review

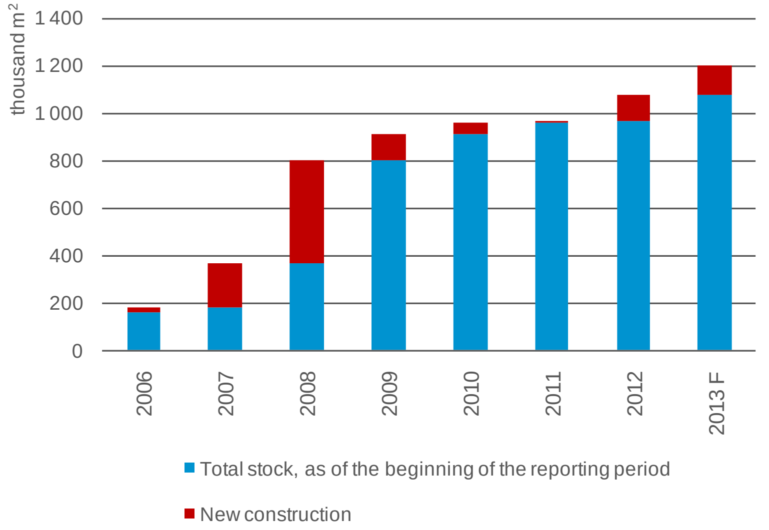
St. Petersburg - industrial market overview

St. Petersburg industrial and warehouse market faces lack of speculative warehouse space, which results in vacancy rate at around 1%. New supply announced for 2013 will hardly add available speculative space to the market, as the projects are already partially preleased.

Supply

In the beginning of 2013 the total speculative supply of St. Petersburg quality warehouse market (leased and offered for lease) remained at 1.07mn sq m. Completions level remains at low levels. For example, in Q1 2013 there was no new supply in the market, while in 2012 the total volume of completed warehouses was 105,000 sq m. Future pipeline demonstrates positive signs of supply recovery. About 125,000 sq m of new high-quality facilities will be opened in St. Petersburg in 2013. However, these new projects will not bring sufficient volume of empty space for lease, as long as there is an emerging trend to conclude preliminary lease agreements as it was in 2006-2007.

Total stock and new construction dynamics.



Demand

In 2012, tenants demonstrated a high demand for warehouse space in the St. Petersburg. The net take-up of industrial space in operating complexes made up 150,000 sq m, which is 4% lower compared to 2011. In Q1 2013 the take-up of quality warehouse space made up about 11,000 sq m. Further take-up will be partially limited due to the lack of space.

In terms of source of demand, retail companies are still the most active participants in the market (their market share reaches 63%). Logistics operators decreased their share in the general demand structure to 34%, production companies — to 3%. It is worth to note, however, that high activity on the warehouse market still does not result in strong increase of the deal size. The major share of deals closed in 2012 – Q1 2013 was in the range 4,000-5,000 sq m per deal (i.e. one or two standard warehouse blocks), with only 3-4 deals exceeding 10,000 sq m barrier.

Shortage of vacant space in operating high-quality warehouse complexes is leading to reorientation of the tenants' demand to operating warehouse facilities of lower quality, new projects under construction and industrial parks.

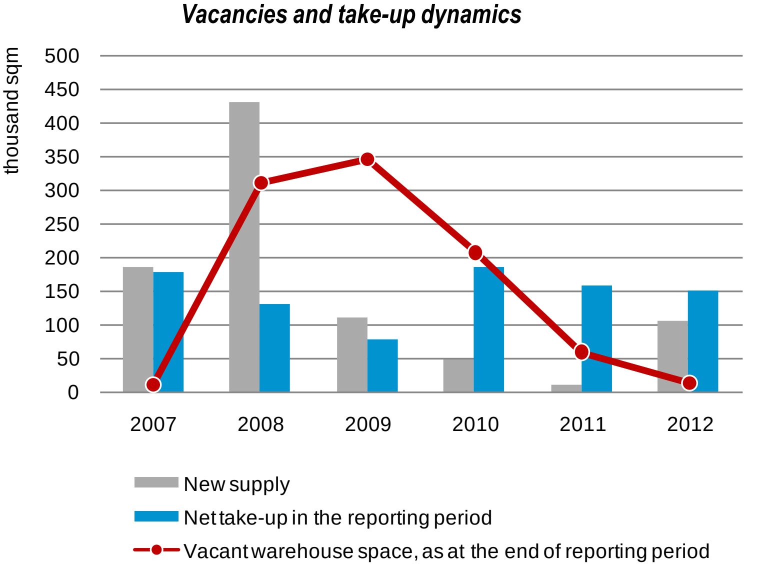
Source: AEB North-Western Regional Committee, Construction and Real Estate sub-committee

Real Estate Quarterly Market Snapshot Review

On the other hand, low vacancy rate and a small number of complexes under construction force the companies, which are interested in new spaces, to consider options for construction of own warehouse complexes, including participation of the professional industrial developers (built-to-suit scheme). New industrial and warehouse projects implemented under built-to-suit and tailor-made schemes gradually enter the active development stage. There are several such projects in the city: distribution centres, service centres and light industrial facilities.

Vacancies and rental rates

The average market vacancy rate remains low at 1.1% due to take-up volumes exceeding new supply. Future projects will hardly influence the situation significantly, as they are partially or completely preleased depending on the project and landlord policy. This supply/demand misbalance keeps rents at a high level, with $120-125 sq m/year for Class A projects, and $98-117 sq m/year for Class B projects (net of VAT, OPEX and utilities).



Trends and forecasts

- Low size of a single leasing deal on the warehouse market will continue influencing developers. New speculative projects will be carefully phased and delivered gradually, with next phase started upon full lease of the previous.
- The majority of industrial property developers prefer implementing projects for specific customers, which largely reduces the potential risk of insufficient occupancy of the premises and makes the investments more effective.
- Due to the fact that the volume of new construction in 2013 will drop behind the average take-up level, vacancy rate will remain low.
- Moderate growth of rental rates in 2013 is expected.

Source: AEB North-Western Regional Committee, Construction and Real Estate sub-committee

Hot Topic

Seizure of Real Estate in New Moscow

by Ekaterina Lapidus, Associate, Dentons

The boundary between the federal city of Moscow and Moscow Oblast was changed on 1 July 2012. A number of Moscow Oblast territories were joined to Moscow to form what has been dubbed "New Moscow".

In April of this year, Federal Law No. 43 on the Particulars of the Regulation of Certain Legal Relations in Connection with the Amalgamation of Territories into City of Federal Significance Moscow and on Amendments to Certain Legal Acts of the Russian Federation of 5 April 2013 ("**Federal Law No. 43**") entered force. This law provides a simplified procedure for seizing real estate (in particular, land) to locate federal and regional facilities for government functions concerning utilities, transportation and social infrastructure, as well as other facilities yet to be approved by the RF and Moscow Governments.

Under Federal Law No. 43, real estate can be seized:
1. by purchase, if the seized property is owned by the rights holder; or
2. by termination of rights to the property and compensation of losses if the rights holder holds the property based on a right other than ownership.

Notably, seizure of land is also permitted if the rights have not been registered in the Consolidated State Register of Real Estate (CSRRE), as well as if the land has not undergone cadastral registration and has been formed as land plots.

Under Federal Law No. 43, the seizure process for state and municipal needs involves the following stages:
1. The authorized state or municipal authority adopts a decision on seizure.
2. The owner and land users/possessors/tenants are given notice of the decision on seizure at least five months in advance of the seizure by being forwarded a copy of the decision. The state authority which adopted the seizure decision is responsible for sending such notice.
3. State registration of the seizure decision is registered in the CSRRE as an encumbrance, with subsequent notification of the owner.
4. The seized property's value is appraised. The value of the seized property and/or losses caused by seizure is/are determined by an appraiser under a state contract with an executive authority empowered to decide on the seizure of real estate.
5. A purchase agreement for the real estate with the owner is executed and a transfer and acceptance certificate between the public authority and the owner is drawn up. This agreement is not subject to state registration and is effective from the execution date.
6. Should the owner agree to enter into the purchase agreement, the purchase price for the real estate is paid to the owner and passage of title from the existing owner to the state undergoes state registration.

Federal Law No. 43 provides for the above procedures to be completed within five months of the competent state or municipal authority adopting the relevant seizure decision.

If the owner or rights holder objects to the seizure, the competent public authority will bring a purchase claim in court. Federal Law No. 43 provides a three year period from the adoption of the relevant seizure decision for such a claim to be brought. In the event of a compulsory seizure, the conditions of such seizure will be determined by the court.

The owner or rights holder of the relevant real estate is also entitled to challenge the purchase price determined by an appraiser in court. However, the existence of such a dispute does not prevent a court from issuing a compulsory purchase judgment, or the commencement of relevant payments and state registration of the transfer or termination of rights and encumbrances in respect of the relevant real estate.

As a separate issue, third party encumbrances over relevant real estate (pledge, lease, gratuitous use rights, etc.) will terminate at the same time as the owner's rights in respect of the relevant real estate. Therefore, Federal Law No. 43 is also a threat to the rights of tenants and servitude users etc., and not only to the rights of property owners in New Moscow.

There are as yet no precedents for the practical implementation of Federal Law No. 43 provisions, given that the relevant lists of federal and regional facilities for state functions with respect to utilities, transportation and social infrastructure, or other facilities, have not yet been adopted by the RF and Moscow Governments. However, officials from the department for development of the new Moscow territories have stated that Federal Law No. 43 will soon be used for the construction of a number of roads in New Moscow. In particular, these include roads from Mamyri to Salaryevo, Kommunarki to Yuzhnoye Butovo and a section of highway from Kievskoye shosse to Borovskoye shosse.

Although the introduction of the simplified seizure procedure had been expected with regard to the planned development of New Moscow, it has nevertheless forced a great number of participants in the real estate market (developers, landlords, investors) to adopt a wait-and-see position in New Moscow. As a result, we are now seeing a reduction in the number of real estate transactions and construction projects in New Moscow.

Hot Topic

Tenants Increasingly Demand Quality And Professionalism From Landlords

by Kate McMurtie, National Director, Head of International Client Services, Corporate Solutions Group
Jones Lang LaSalle

About occupier trends
The most important points for occupiers in the market today remain price, locations with good public transport access, landlord professionalism, and building quality. In terms of quality, corporate tenants are more and more focused on buildings that are efficient and provide for more cost-effective space layouts. Thankfully, we now have more projects like this in the market and new options on the way. Regarding tenant-landlord relationships, tenants are interested in longer term partnerships with landlords who can demonstrate commitment to and delivery of consistently good quality building services and tenant support. Many tenants have been disappointed in the past by empty promises of landlord professionalism and definitely want to improve this element in their real estate portfolios going forward. As for location, aside from tenants who for different reasons remain "captive" to the city centre, I know that many corporate tenants in Moscow are still dreaming of campus style office buildings just beyond the TTR that would be more cost effective, provide a better working environment, within walking distance to the metro and away from the traffic hotspots. This is still quite a tall order for Moscow, however.

Decentralization
Historically, there are some business sectors that have been very tied to the city centre and the Kremlin area. We have seen some growing flexibility and desire from these sectors to consider moving further afield in search of lower costs, but rarely an outright step away from the CBD. The rest of the business world is much more open to the opportunities to decentralize. We have some great examples of decentralized Class-A projects that occupiers would like to see replicated: like "Krylatsky Hills", "Metropolis", and "Olympia Park".

Landlord/occupier relations
In terms of the relationships between landlords and occupiers in 2013 I think there are still significant differences between landlords in terms of quality and approach to tenants. We now have a group of landlords in this market who are really pulling away from the pack and showing what they are able to do in terms of offering stable professional working environments for their clients and ensuring that building and tenant services are delivered to a higher standard - and this is very encouraging. Our corporate clients would clearly like to see more of this trend and this is undoubtedly also linked to the development of an institutional investment market as well. Landlords should look at corporate tenants as long-term business partners as opposed to short-term sources of revenue. Within this group of forward-thinking landlords, I'd say we've seen some very positive improvements and we believe it's going to continue. Beyond this main group, there is still considerable room for improvement, but I trust this new group will be setting the pace for the rest to follow.

Rents
Without a doubt – price sensitivity will continue to be a major factor driving real estate decisions for tenants in 2013, in contrast to 2007 and 2008 when tenants had very little choice in the matter. Today, 10 out of 10 of our clients are watching their costs in a much more careful manner and reconsidering their workplace strategies. Most corporates are also more sophisticated in terms of their experience in procuring real estate in Russia and are better equipped to understand the analysis of their present and future real estate costs beyond just the headline financial terms in a landlord's offer.

Prime rents in Q1 remained unchanged at the level of USD 1,000 to USD 1,150/sq m per year. Overall CBD Class-A rents were recorded at levels between USD 650 – 1,150 sq m per year. Moscow City represents a growing opportunity for occupiers with rents varying from USD 650–950. Attention to cost is increasingly driving tenants towards lower-cost options outside the CBD space. In this respect, decentralized locations (TTR to MKAD) displayed the most attractive rents with USD 450–700 for Class-A premises.

I think that a number of landlords may still underestimate how important cost optimization is to corporate tenants and if we see that this trend continues, we may see more tenants re-thinking their priorities in terms of location and opening up further to the idea of alternative locations. Despite this sensitivity to cost, I think most international businesses will still look to Russia as an area for growth and profitability.

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