1/2016

# AEB REAL ESTATE MONITOR

Magazine of the Association of European Businesses

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**Frank Schauff**
Chief Executive Officer,
Association of European Businesses

# Dear readers,

Nowadays the real estate market is facing a rebuilding of the economic model. Growth in real estate prices was driven mostly by high oil prices and the availability of Western credits to Russian banks. Foreign investors are not willing to risk investment in a country which has a clouded outlook. For the majority of the population which had been contemplating the purchase of an apartment in recent times, maintaining a basic standard of living has now taken precedence, and the acquisition of real estate has been put on hold.

The number of apartments for sale on the second-hand market has grown dramatically. And while there is an almost absence of buyers, sellers, at the same time, are resisting price cuts. In addition, the lack of access to mortgages is further reducing demand from potential customers. All of these factors suggest that demand for residential property is unlikely to recover for several years.

Even the most optimistic experts already acknowledge that current prices do not correlate with the incomes of most of the population. Of course there are numerous well-off people that even today can afford to buy apartments, but they recognise the real estate market as investment tool.

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

I would like to take this opportunity to thank the members of our Real Estate Committee who have actively contributed to this publication as well as other Committee-related activities.

Enjoy your reading!

**Filippo Baldisserotto**
Chairman of the AEB Real Estate Committee,
General Director,
Stupino 1 Industrial Park

# Dear readers,

The first month of 2016 has brought us a continuation of the current economic turbulence. Oil prices have continued to drop and the consequent volatility on the currency market has added to the further slide of the rouble against the dollar and euro. The situation as before remains challenging for the real estate sector, which has already seen major changes and a drop in demand and prices in the last couple of years.

Nevertheless, being on the optimistic side and understanding that everything is cyclical, even if cycles may undergo changes themselves, we believe that real estate market players will adapt to the situation by redefining strategies, priorities and volumes.

On our part, the Real Estate Committee is planning a number of meetings and events aimed at helping the real estate community better understand the current trends and changes. We will continue to keep you updated on changes to legislation and circumstances in the real estate market throughout the year. In addition, we will provide you with a general update at the second annual conference Real Estate Day at the end of September this year.

We invite all Real Estate Committee members to contribute to our work and share their experience, knowledge and practices with our readers – both AEB and non-AEB members.

Thank you all and we are looking forward to seeing you at the upcoming Real Estate Committee meetings and events.

# Moscow market overview

## Capital market

• Inflationary expectations remain elevated and debt financing is still very expensive, moreover, oil prices continue to slump. Nevertheless, rents on the real estate market are starting to show signs of bottoming out. Investment volumes remain subdued (**1, 2, 3**)

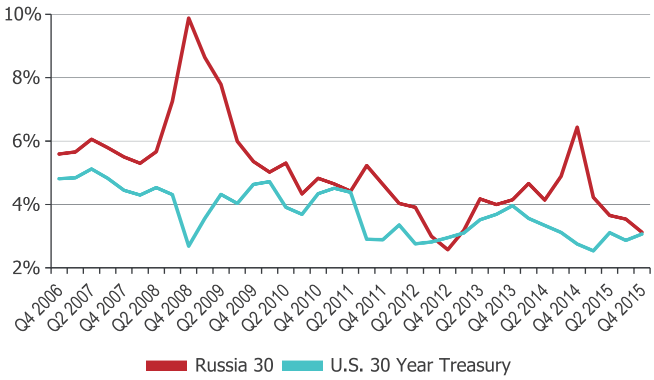
**1**


Source: JLL

**2**


Source: JLL

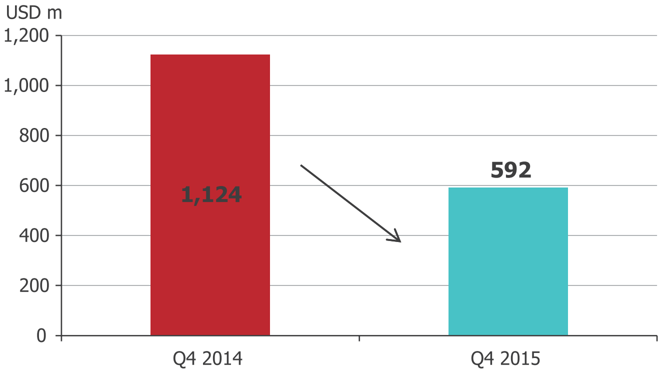
**3**




Source: JLL

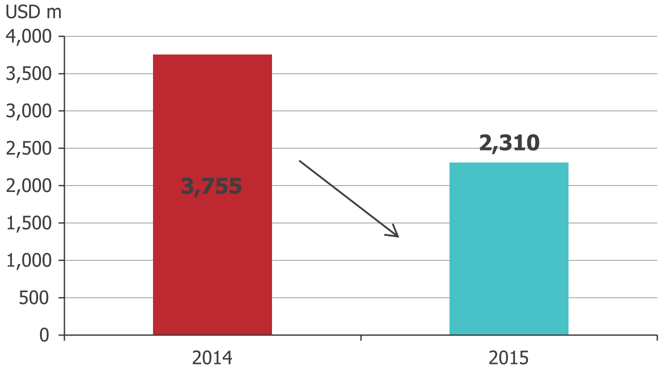
• In 2015, investment volumes in Russian real estate decreased by 38% year-on-year to total USD 2.3 bn. This figure includes Q4 investment volumes of USD 592 mln, which was down 47% YoY. (**4, 5**)

**4**




Source: JLL

**5**

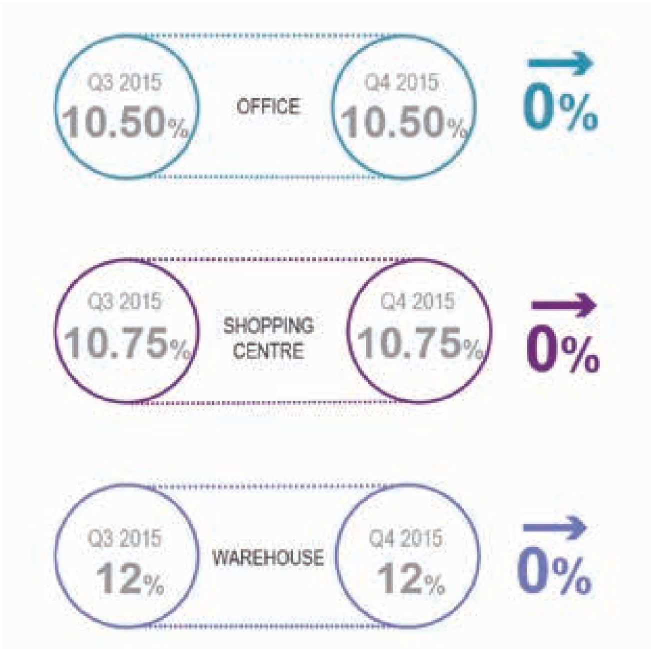



Source: JLL

• We project investment volumes to reach USD 4 bn in 2016, although we continue to see downside risks in the short term.

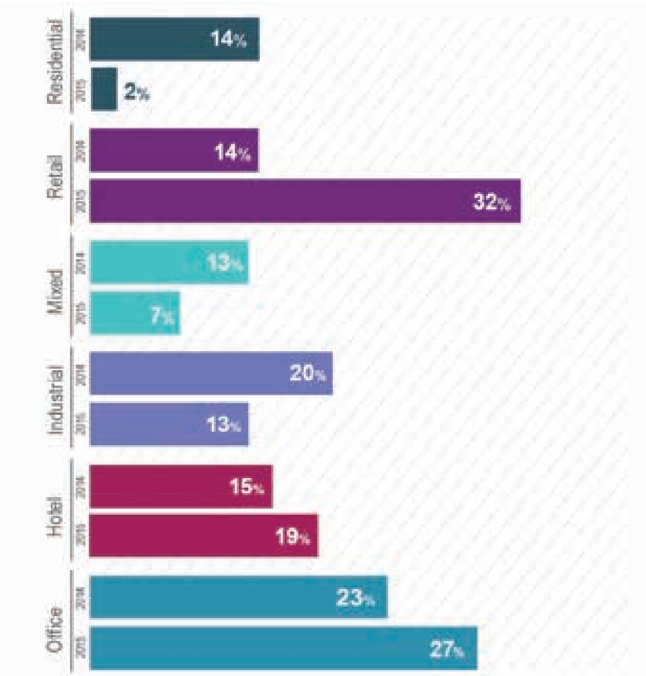
• In Q4 2015, the yields for prime office and shopping centre space in Moscow remained at 10.5% and 10.75%, respectively, while warehouses recorded a yield of 12%. We believe the demand cycle is now passing through the trough, suggesting that rates may start to fall across all sectors during 2016. (**6**)

**6 ▶**




Source: JLL

**7 ▶**

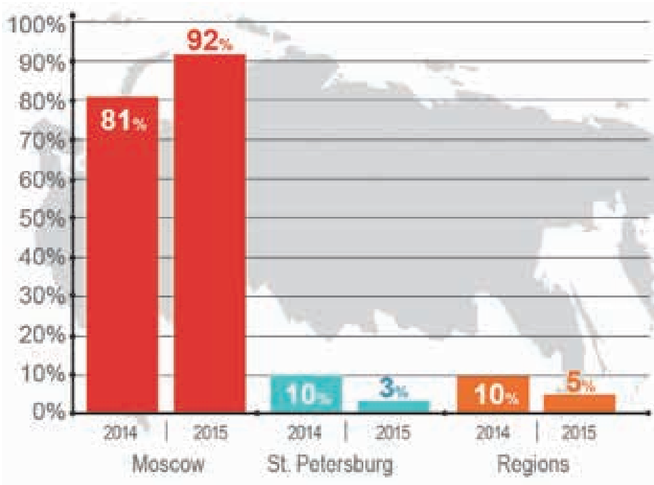



Source: JLL

• In 2015, the retail segment accounted for 32% of total investment volume supported by the sale of Modny Sezon. Moreover, the share of the office sector reached 27% as a result of the sale of two buildings in the Metropolis BC. (**7 ▶**)

• Investors continued to focus on assets located in Moscow in 2015. These accounted for 92% of total volumes. Investments in St. Petersburg reached USD 61 mln in 2015 compared to USD 364 mln the previous year, reducing the share from 10% in 2014 to 3% in 2015. (**8 ▶**)

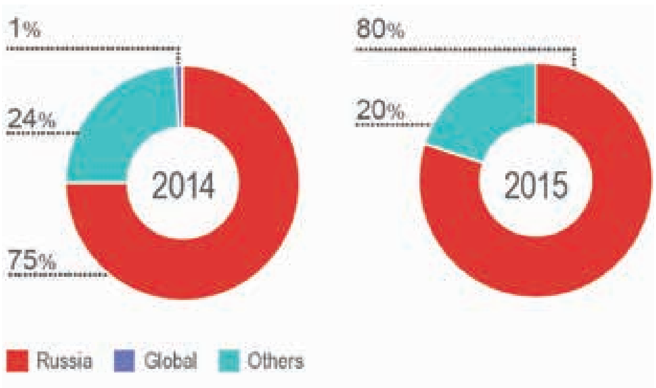
**8 ▶**




Source: JLL

• The share of foreign capital in Russian investment transactions dropped to 20% in 2015 from 25% in 2014. (**9 ▶**)

**9 ▶**

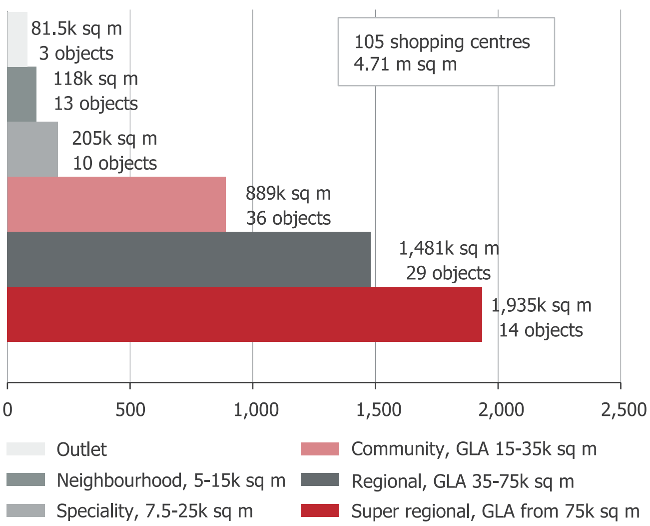



Source: JLL

# Retail market

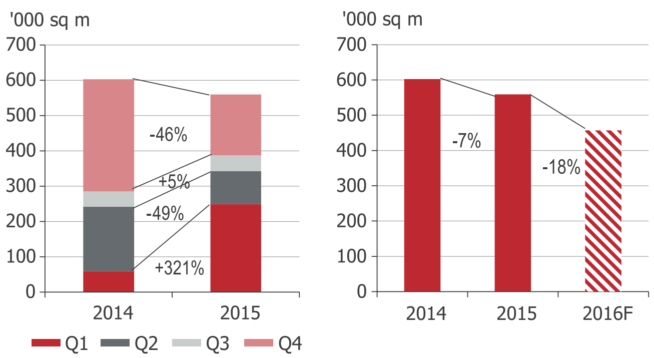
• In Q4 2015, Moscow's shopping centre market saw the completion of projects including Zelenopark (110,000 sq m*), Avenue South-West (40,000 sq m) and Kalita (22,000 sq m). As a result, the area of new shopping centre supply in Moscow dropped 7% YoY to 560,000 sq m in 2015. According to our estimates, around 460,000 sq m of quality shopping centre space will be completed in the next 12 months, which is 18% lower than the 2015 figure. It should be noted, that 90% of the completions in 2016 will come from postponed projects. (**10, 11** ▶)

## 10 ▶ SHOPPING CENTRE SUPPLY




Source: JLL

## 11 ▶ SHOPPING CENTRE COMPLETIONS

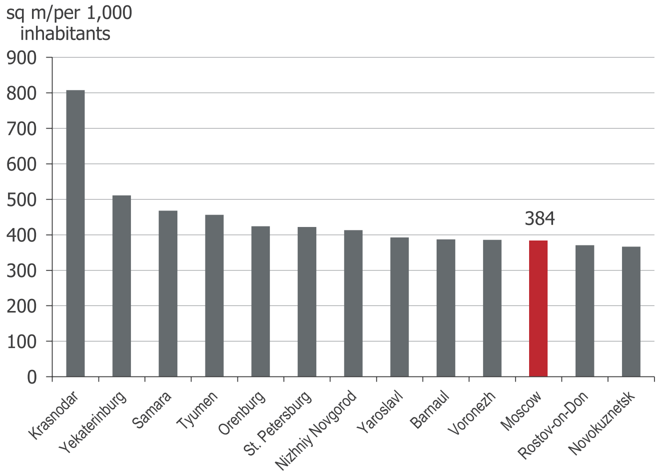



Source: JLL

* Hereinafter we use gross leasing area (GLA)

• At the end of 2015, the shopping centre density in Moscow increased to 384 sq m per 1,000 inhabitants from 345 sq m the previous year. Based on the current forecast for shopping centre completions, Moscow will have 420 sq m per 1,000 inhabitants in terms of shopping centre density at the end of 2016. (**12** ▶)

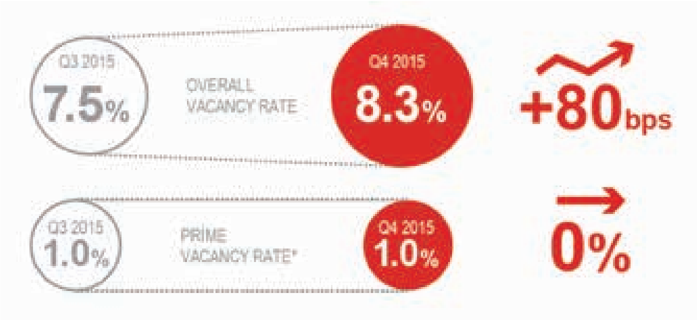
## 12 ▶ FLOOR SPACE PER 1,000 INHABITANTS IN RUSSIAN CITIES




Source: JLL

• The vacancy rate of Moscow's shopping centre market reached 8.3% in Q4 2015, an increase of 0.8 pp QoQ and 2.3 pp YoY. Nevertheless, in the core successful shopping centres it remained at 1% in Q4, the same level as the previous quarter. The availability has increased due to both the high volume of new Moscow retail supply and the active rotation of tenants who are under pressure due to the sagging consumer demand. (**13** ▶)

### 13 ▶ AVAILABILITY




[*] based on the basket of the most successful shopping centres with high footfall and conversation rates

Source: JLL

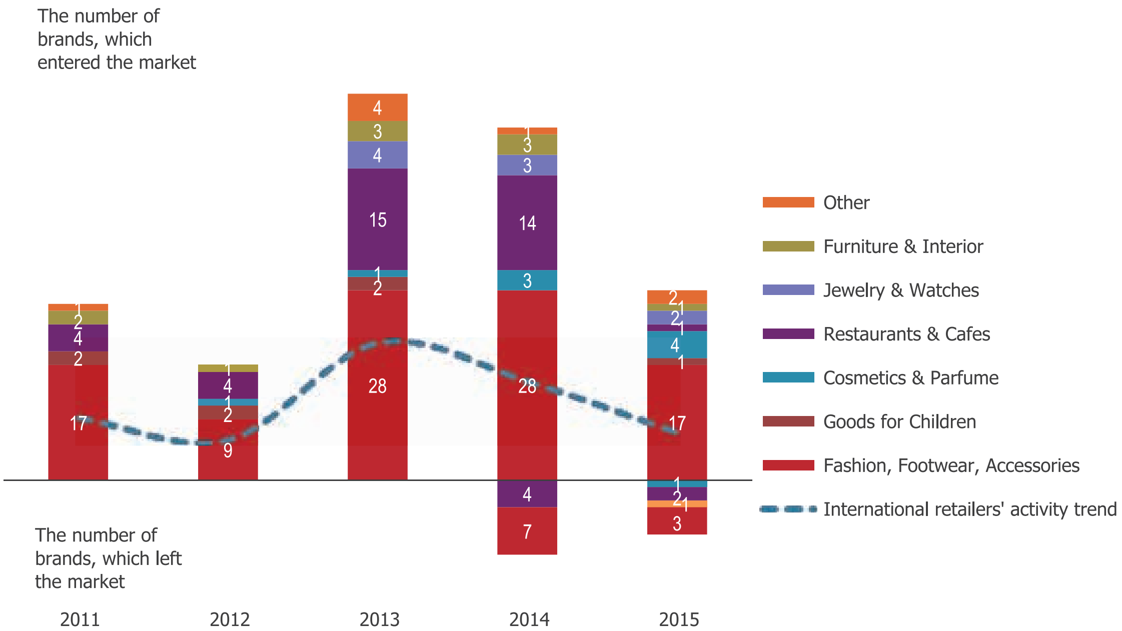
### 14 ▶ PRICING


Source: JLL

[*] Hereinafter we use gross leasing area (GLA)

• The rents at Moscow shopping centres declined by 15% in Q4 2015. Today, the annual rental rates for prime space in shopping galleries stands at USD 1,700–3,220 per sq m, while rents on average range at USD 340–1,230. JLL experts do not expect to see any improvements in these indicators in 2016 due to the weak economy. (**14, 15 ▶**)

### 15 ▶ NEW RETAILERS ON THE RUSSIAN MARKET: DYNAMICS OF ENTRIES AND EXITS

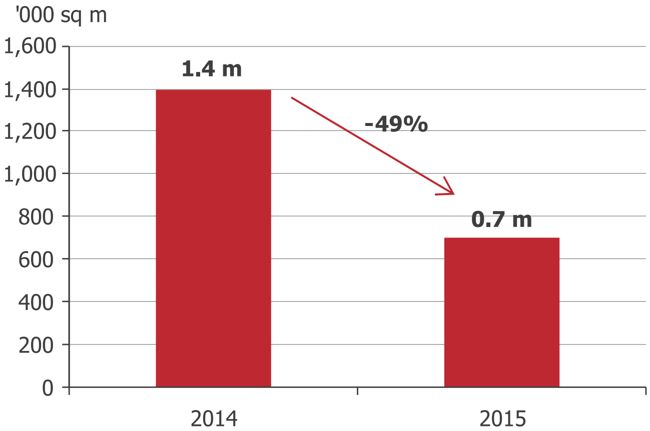



Source: JLL

# Office market

• In the last quarter of 2015, approximately 257,000 sq m of quality office stock was delivered to the market. This was almost 30% less than in the same time period last year. The total new supply in 2015 was close to 700,000 sq m, which was half the amount of new space delivered in 2014. Nearly half of the new supply of office premises in 2015 were Class A or 327,315 sq m in absolute terms. (16 ▶)

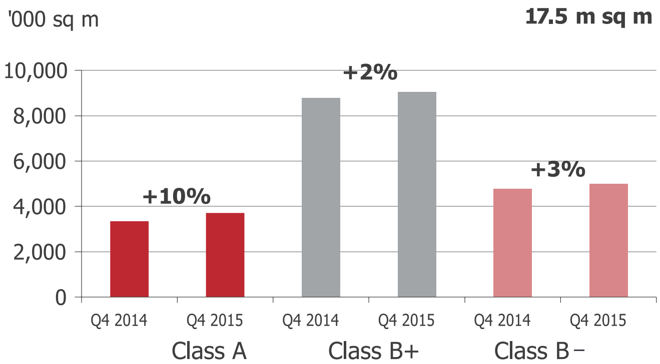
**16 ▶**




Source: JLL

• Another 700,000 sq m of new office space is likely to be commissioned in 2016. In the longer term, we expect that the future supply of office space will be much smaller compared to previous years due to the end of the current construction cycle. (17 ▶)

**17 ▶**




Source: JLL

• In Q4 2015, the volume of office take-up was 252,389 sq m. Over the whole year the amount of space absorbed from the market was approximately 1 mln sq m, representing a drop of about 3% YoY. Occupier activity remained strong in 2015 with renegotiation deals comprising more than 63% of all deals.

• By the end of 2015, total vacancy decreased to 16% from 17% in Q3. A significant decline was recorded in Class A from 27.4% in Q3 to 23.1% by the end of the year.

• The asking rents for premium offices stood at 600–800 USD/sq m/year in Q4 while Class A asking rents were 400–600 USD/sq m/year and Class B+ asking rents were 14,000–22,000 RUR/sq m/year. The actual rental price depended on numerous factors such as vacancy level in a particular building, the level of incentives and the landlord's general financial position. (18 ▶)

**18 ▶ Base Rents**

| USD/sq m/year | | RUB/sq m/year | |
|---|---|---|---|
| Prime* | Class A | Class B+ | Class B – |
| 600–800 | 400–600 | 14,000–22,000 | 8,000–13,000 |

* Rents in high quality buildings in the Central Business District (CBD)

Source: JLL

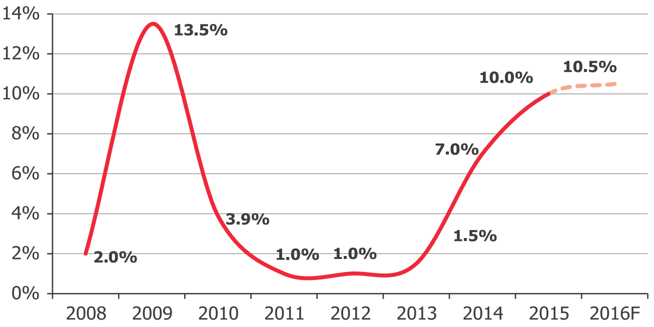
# Warehouse market

## TRENDS

The transition to roubles and decrease in rental rates allowed major food and household goods retailers to realise pent-up demand in 2015. Due to this, the vacancy rate and rental rates stabilised at the end of the year in spite of the difficult economic climate.

In the fourth quarter of 2015, the interest of retail chains in the Moscow region decreased and in the mid-term demand for warehouse space in the region will depend on the situation in the Russian consumer sector and will be lower than 2015 levels. At the same time rental rates in roubles and the vacancy rate will remain at 2015 year-end levels due to lower real estate development activity. (19 ▶)

### 19 ▶ VACANCY RATE, CLASS A




Source: Cushman and Wakefield

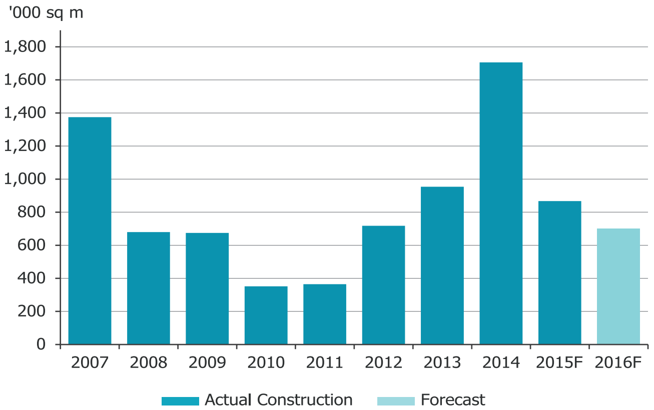
## MOSCOW REGION | NEW CONSTRUCTION

Compared to 2014, new construction in 2015 decreased twofold and comprised 876,000 sq m. Total stock increased by 7% and comprised 11.7 mln sq m. No new projects have been announced. Developers continue to develop projects announced earlier (in 2014), but are regularly postponing delivery dates of the projects under development, and in some cases the delay is more than a year.

According to preliminary estimates the supply will increase by 700,000–750,000 sq m in 2016, the construction of speculative projects at final stages of development will be completed and mostly built-to-suite projects will be started. (20 ▶)

New warehouse projects delivered in 2015 generally did not change the geographical distribution of warehouse space in the Moscow region.

### 20 ▶ NEW CONSTRUCTION, CLASS A AND B ('000 SQ M)

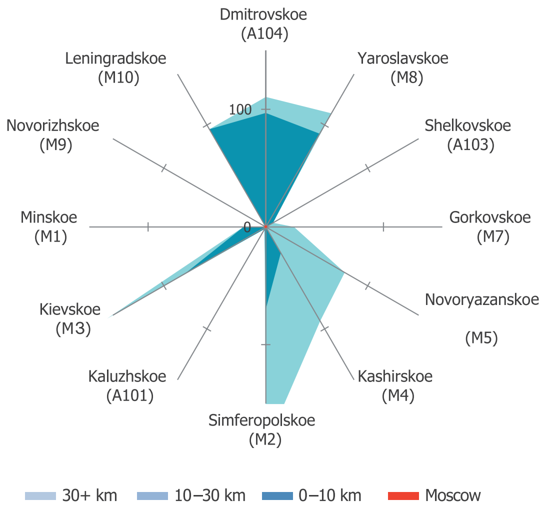



Source: Cushman and Wakefield

The biggest proportion of warehouse premises are located on Simferopolskoe highway (17% of the total warehouse space in the region), 15% on Novoryazanskoe, and 14% on Kashirskoe highway.

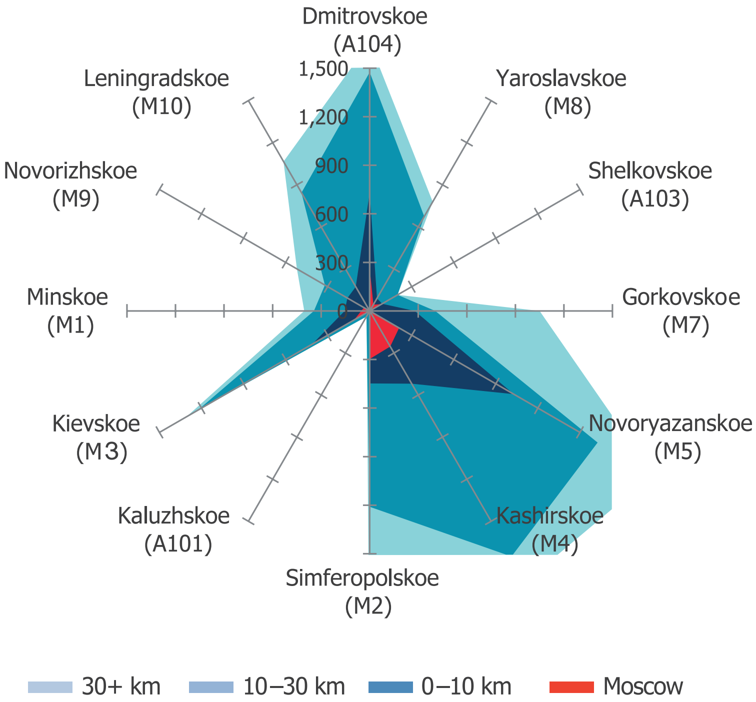
The smallest proportion of warehouse premises are located on Kaluzhskoe and Minskoe highway. Most of the warehouse space (46%) is located at a distance of 10 to 30 km from Moscow. (21, 22, 23 ▶)

### 21 ▶ GEOGRAPHICAL DISTRIBUTION OF NEW QUALITY WAREHOUSE SPACE DELIVERED IN 2015 ('000 SQ M)




Source: Cushman and Wakefield

## 22 ▶ GEOGRAPHICAL DISTRIBUTION OF EXISTING QUALITY WAREHOUSE SPACE BY HIGHWAY (‘000 SQ M)




Source: Cushman and Wakefield

## MOSCOW REGION | DEMAND

Lease and purchase deals in 2015 exceeded 2014 by 23% and comprised 1.1 mln sq m. The increase in take-up was supported by food and household goods retail companies realising their pent-up demand.

Purchase deals comprised 21% of total deals, which is a 7% drop from 2014.

There has been an increase in tenant activity to renegotiation existing lease contracts. Many current lease agreements are still nominated in USD and we expect the tenants to be active in lease renegotiations in 2016.

Furthermore, companies are continuing to give up excess space, consolidate warehouse premises and relocate to higher class warehouse complexes. (24 ▶)

## 23 ▶ BIGGEST WAREHOUSE PROJECTS IN THE MOSCOW REGION COMPLETED IN 2015

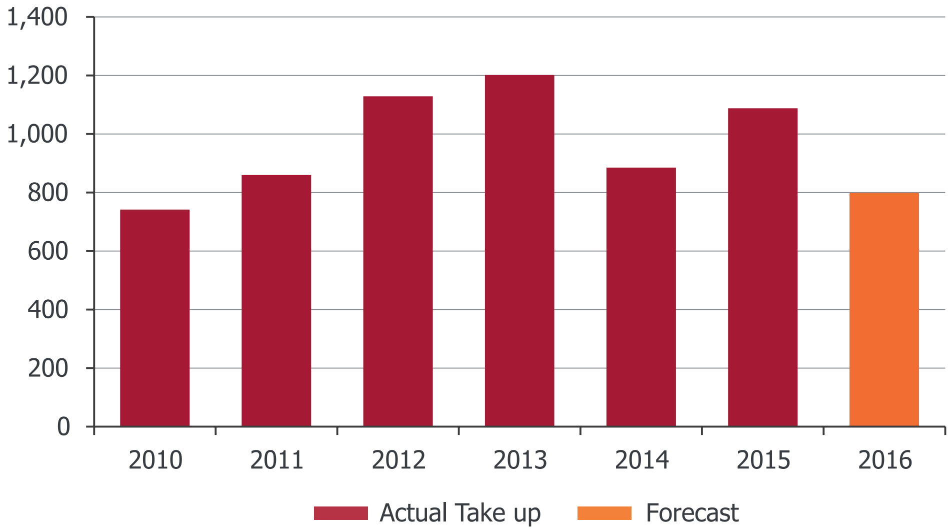
| Project | Highway | Distance from MKAD, km | Total area, ‘000 sq m | Delivery |
|---|---|---|---|---|
| Kievskoe 22 Logopark | Kievskoe | 22 | 92.6 | Q1 |
| Sofyino Logopark | Novoryazanskoe | 32 | 91.0 | Q1 |
| Logopark Sever – 2 | Leningradskoe | 30 | 49.2 | Q1, Q3 |
| Synkovo logistic park | Simferopolskoe | 27 | 41.4 | Q1, Q4 |
| PNK-Chekhov III | Simferopolskoe | 49 | 102.2 | Q2 |
| PNK-Bekasovo | Kievskoe | 48 | 91.6 | Q2, Q3 |
| Kholmogory industrial park | Yaroslavskoe | 30 | 91.5 | Q2 |
| PNK-Chekhov II | Simferopolskoe | 50 | 34.9 | Q2 |
| Sherrizon-Nord | Leningradskoe | 16 | 62.2 | Q4 |
| PNK-Severnoe Sheremetyevo | Rogachevskoe | 27 | 106.5 | Q4 |

Source: Cushman and Wakefield

As we forecasted in 2014, take-up dramatically changed in 2015. The proportion of retail chains increased from 31% to 54%, while the proportion of all others declined. The proportion of logistics companies reduced the most, halving from 2014.

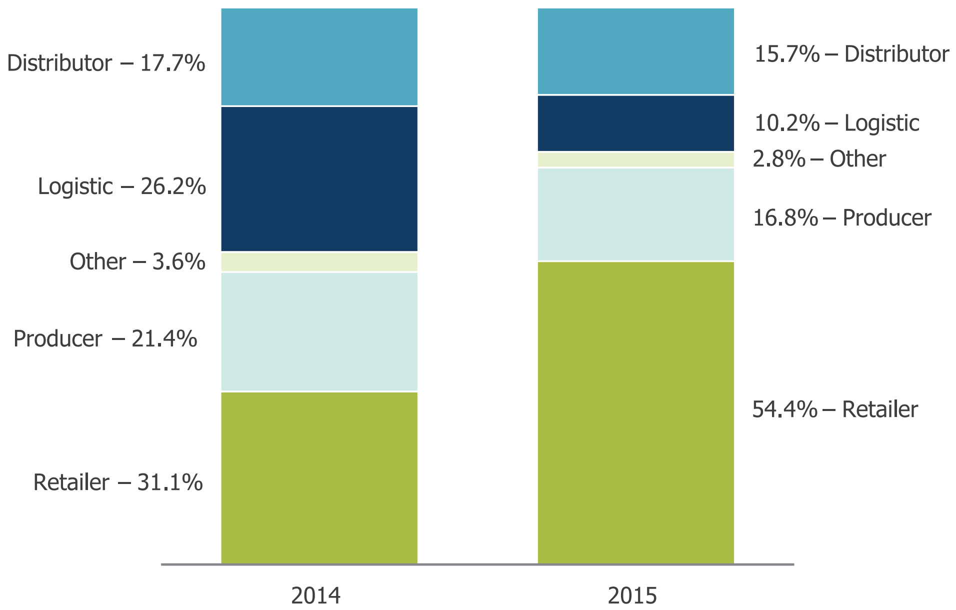
The value of the average deal in 2015 in the majority of segments dropped by 20–25% from 2014. The exception was the retail segment, where the take up doubled in 2015 and comprised 27,000 sq m. (**25 ▶**)

**24 ▶ TAKE UP, CLASS A AND B**




Source: Cushman and Wakefield

**25 ▶ TAKE UP**

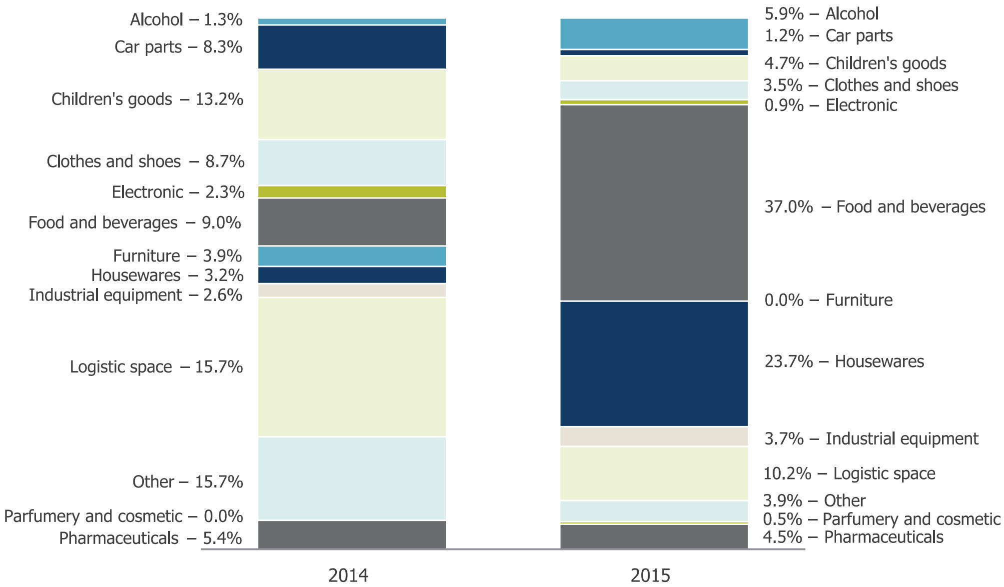



Source: Cushman and Wakefield

In 2015, demand by sector underwent great changes. The proportion of food and drink and household goods companies increased sharply by 4 and 7 times respectively from 2014. The increase was both in terms of the value of the deals and the number of them.

At the same time there was a sharp decrease in the auto-components, electronics, clothes and shoes, and logistics segments due to the crisis in these sectors. (**26, 27**)

## 26 TAKE UP STRUCTURE




Source: Cushman and Wakefield

## 27 KEY TRANSACTIONS IN 2015

| TENANT/BUYER | PROJECT | DEAL TYPE | Total area, '000 sq m |
|---|---|---|---|
| X5 Retail Group | Logopark Sofyino | Lease | 65.7 |
| Dixi | PNK-Severnoe Sheremetyevo | Buy | 55.1 |
| Dixi | A-Terminal | Lease | 54.3 |
| Dochki-Synochki | Logopark Bykovo | Lease | 42.2 |
| Globus | Kholmogory industrial park | Lease | 40.1 |
| OBI | Logopark Sever – 2 | Lease | 35.8 |
| Puls | MLP-Leningradsky terminal | Lease | 31.7 |
| Lenta | PNK-Chekhov III | Buy | 31.0 |
| Krasnoe I Beloe | Synkovo logistic park | Lease | 30.3 |
| Nature Foods | Synkovo logistic park | Buy | 28.0 |

Source: Cushman and Wakefield

## MOSCOW REGION | RENTAL RATES

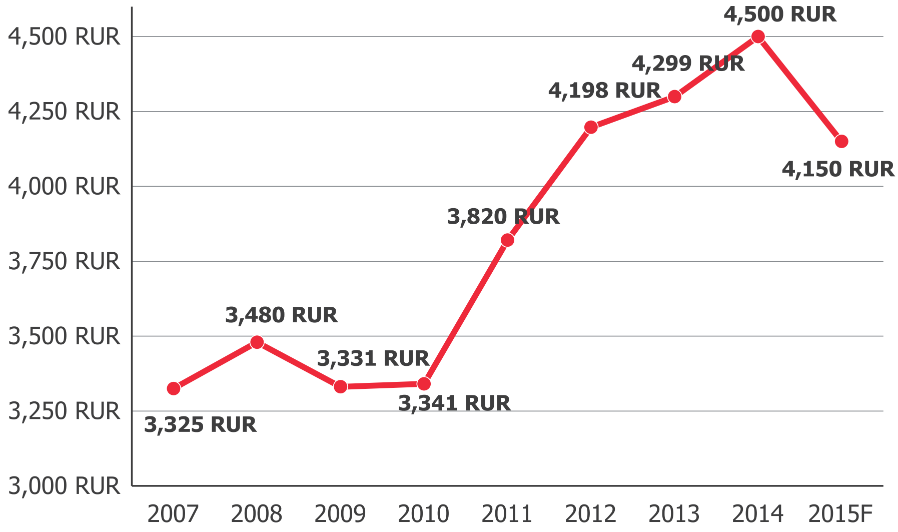
Since the middle of 2015, all rental rates for vacant warehouse space in the Moscow region have been nominated in roubles. The return to rental rates in the dollar equivalent is not expected.

In the first half of 2015, triple net rental rates decreased by 8% and stabilised at RUR 3,800–4,500 per sq m/year.

In the second half of the year, rates did not change.

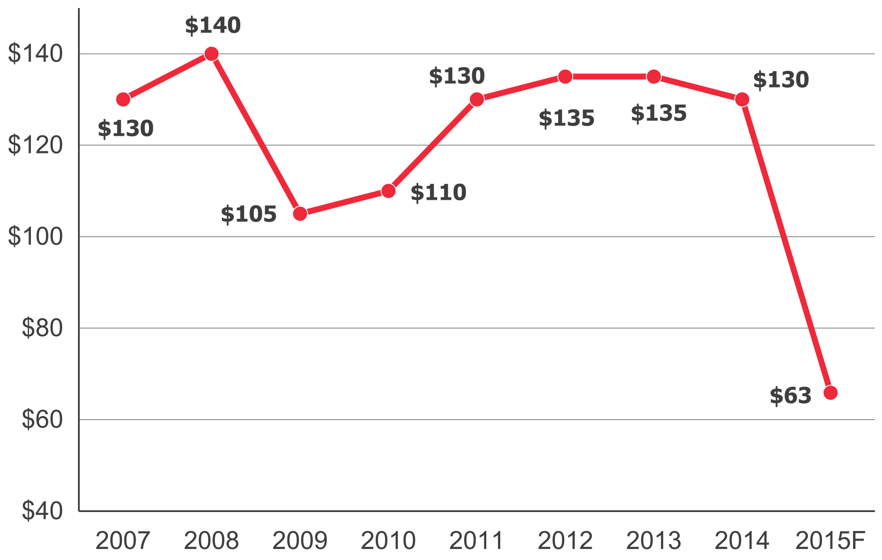
Given that the market situation is difficult, owners have been optimising their costs. Operating expenses in 2015 remained in the range of RUR 1,000–1,300 per sq m/year, depending on the project. (28, 29 ▶)

### 28 ▶ NET RENTAL RATE IN ROUBLES (RUR/SQ M/YEAR)




Source: Cushman and Wakefield

### 29 ▶ NET RENTAL RATE IN US DOLLARS (USD/SQ M/YEAR)*




* Rental Rate is calculated according to average RUR/USD exchange rate as of Q4 2015

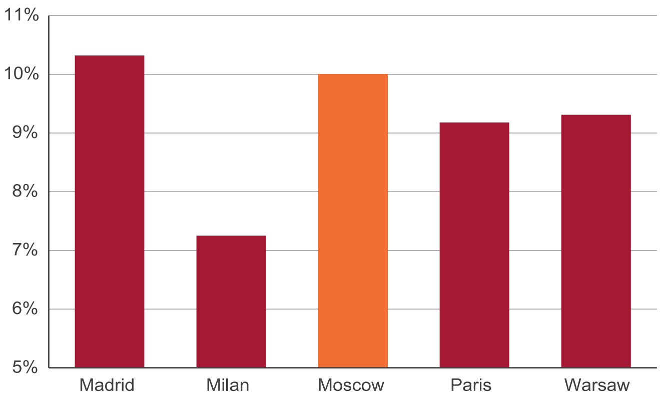
Source: Cushman and Wakefield

## MOSCOW REGION | INTERNATIONAL COMPARISONS

A 10% vacancy rate is deemed high for the Moscow region but not for most of the European warehouse markets. In the markets of Madrid, Barcelona and Milan vacancy rates have varied from 7% to 12% over the past few years.

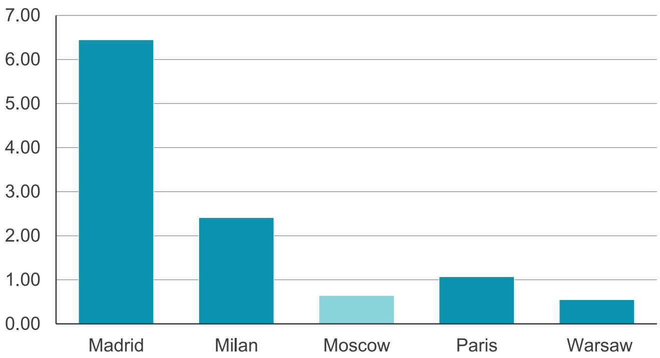
Despite the complexity of the situation, the warehouse market in Moscow retains its potential for growth. The current supply in the region is lower than in the major European cities. (**30, 31** ▶)

### 30 ▶ VACANCY RATE




Source: Cushman and Wakefield

### 31 ▶ QUALITY WAREHOUSE STOCK, SQ M PER 1 CITIZEN




Source: Cushman and Wakefield

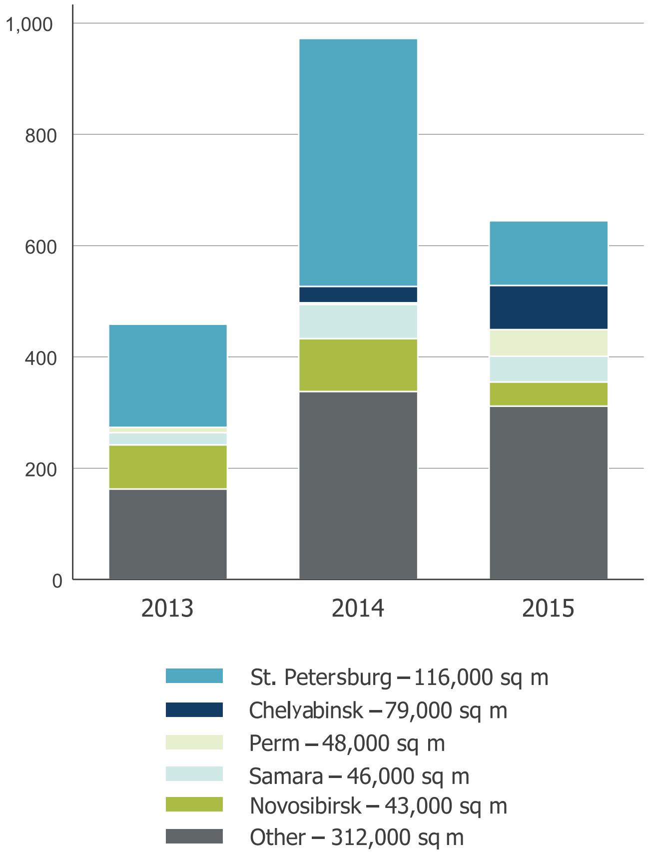
## REGIONS | NEW CONSTRUCTION

Overall, new construction in the regions decreased by 50% in 2015. Developers adjusted their pipeline in accordance with current demand.

The slowdown in construction was due to the contraction in large regional markets. For example, in St. Petersburg 75% less warehouse premises were delivered in 2015 than in 2014. Meanwhile, developer interest in underdeveloped regional markets, such as Perm and Primorsky Krai, remains high.

We expect the same trends to continue next year. New construction will be lower than in 2015 (about 600,000 sq m). Developers will start projects only on the condition that pre-lease or pre-purchase contracts are signed. (**32, 33** ▶)

### 32 ▶ NEW CONSTRUCTION, CLASS A AND B




Source: Cushman and Wakefield

## 33 ▶ BIGGEST WAREHOUSE PROJECTS COMPLETED IN THE REGIONS IN 2015

| Project | Region | Total area, '000 sq m | Delivery |
|---|---|---|---|
| Logocentr-Kuban | Krasnodar | 40.0 | Q1, Q4 |
| PNK-Togliatti | Samara | 26.0 | Q1 |
| TLK Yuzhnouralsky | Chelyabinsk | 82.3 | Q2 |
| Direct Logistics | Voronezh | 39.5 | Q2 |
| Yankovsky | Vladivostok | 26.3 | Q2, Q3 |
| A2logistic Rostov-on-Don | Rostov-on-Don | 33.0 | Q3 |
| SamaraTransAvto | Samara | 28.62 | Q3 |
| A Plus Park Shushary | St. Petersburg | 33.5 | Q4 |
| PNK-Kosulino | Ekaterinburg | 29.7 | Q4 |

Source: Cushman and Wakefield

## REGIONS | DEMAND

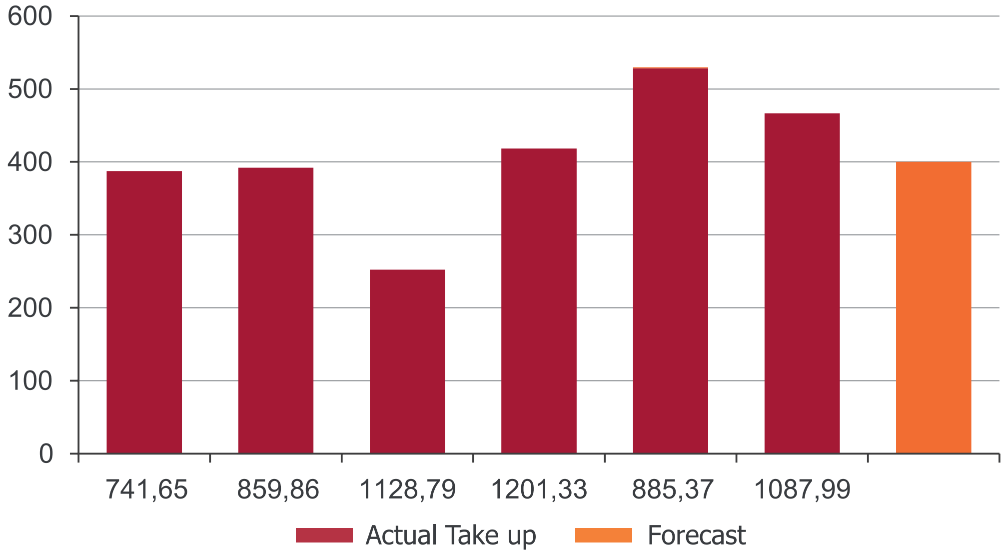
Unlike the Moscow region, the volume of deals in the regions in 2015 was 14% lower than in 2014. Sale-purchase deals comprised 10% of the total deals which was half that of 2014.

The demand in the regions in 2015 was based on retailers, as it was in 2013–2014. Retailers accounted for 50% of the deals in these years.

As in the Moscow region, the food and drink segment accounted for 50%, which is 6.4% lower than in 2014.

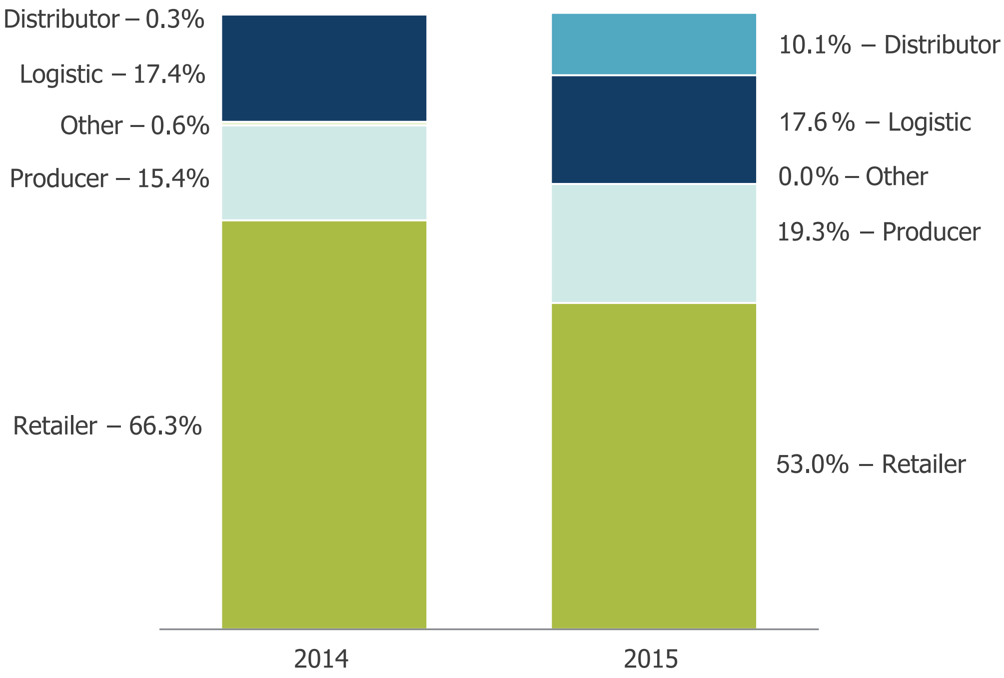
We do not expect the demand in the regions to change much next year, while the volume of leased and purchased space will decrease to 400,000 sq m. (**34, 35, 36, 37**)

### 34 NEW CONSTRUCTION, CLASS A AND B



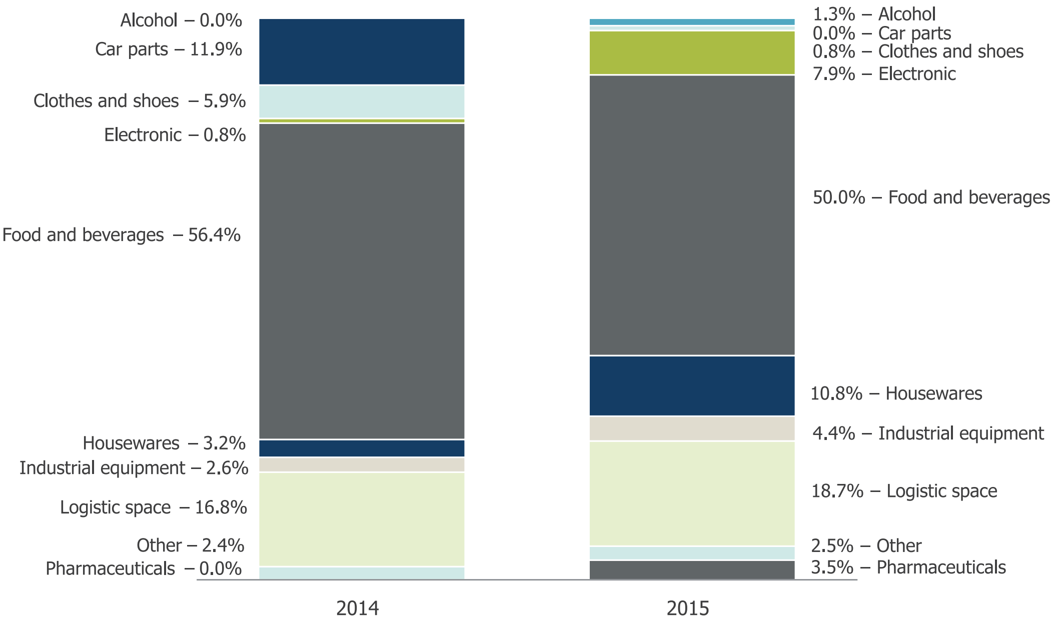

Source: Cushman and Wakefield

### 35 TAKE UP




Source: Cushman and Wakefield

36 ▶




Source: Cushman and Wakefield

## 37 ▶ KEY TRANSACTIONS IN 2015

| TENANT/BUYER | PROJECT | REGION | DEAL TYPE | Total area, `000 sq m |
|---|---|---|---|---|
| X5 Retail Group | Romeks-Kuban | Krasnodar | Lease | 47.0 |
| X5 Retail Group | Freight Villadge Vorsino | Kaluga | Lease | 38.7 |
| SSP-Consult | Scania | St. Petersburg | Bay | 28 |
| X5 Retail Group | A Plus Park Perm | Perm | Lease | 26.4 |
| O'Key | PNK-KAD | St. Petersburg | Lease | 24 |
| Lenta | PNK-Kosulino | Ekaterinburg | Bay | 20.9 |
| Mars | PNK-Tolmachevo | Novosibirsk | Lease | 21.2 |
| Leroy Merlin | SLK | Samara | Lease | 19.9 |
| Delovye Linii | Terminal Chkalovsky | Ekaterinburg | Lease | 19.5 |
| Garghner | Orion logistic | St. Petersburg | Lease | 18.0 |

Source: Cushman and Wakefield

# Hospitality – Moscow hotels in 2015

The average annual occupancy across all market segments of Moscow hotels in 2015 was up to 70% from the 2014 average occupancy of 67%. Sharp currency fluctuations resulted in a 38% decrease in US dollar nominated ADR (average daily rate) and a 34% decrease in RevPAR (revenue per available room), totaling USD 116 and USD 81, respectively. Rouble nominated ADR fell by 1% from 2014 (RUR 7,131), while RevPAR increased by 4% and amounted to RUR 4,928.

The upscale segment figures rose in roubles compared to January–December 2014, while US dollar ADR and RevPAR fell dramatically. Dollar ADR dropped by 36% (USD 184), dollar RevPAR fell by 30% (USD 124). Rouble nominated ADR increased by 2% (RUR 11,258), and the rouble RevPAR by 10% (RUR 7,578). The overall occupancy increased by 5% (67%).

Business hotels demonstrated the following results in 2015. US dollar RevPAR decreased by 37% (USD 65), which was composed of a 3% occupancy increase (70%) and a 40% fall in US dollar nominated ADR (USD 93). The rouble RevPAR remained unchanged and amounted to RUR 3,962, while ADR dropped by 4% (RUR 5,713).

A certain decrease of ADR and RevPAR was observed in the midscale segment, while the overall occupancy grew by 2% (74%). The ADR amounted to USD 72 as a result of a 41% decrease, whilst US dollar nominated RevPAR dropped by 40% and comprised USD 53. The rouble ADR and RevPAR decreased by 7% and 4% respectively (RUR 4,423 and RUR 3,245).

As mentioned above, the continuous extreme fluctuations of the US dollar against the rouble had a significant impact on further declines in the dollar equivalent. As the US dollar went up against the rouble by 63% during 2015, the dollar figures showed a much stronger decline than the rouble ones.

The absolute gap in the RevPAR between market segments has changed and demonstrated the following results:
• The variation between the upscale and midscale segments comprised USD 71/RUR 4,333, compared to USD 90/RUR 3,480 in the same time period of 2014.

• The difference in the RevPAR between upscale and business hotels changed to USD 59/RUR 3,616 compared to USD 75/RUR 2,914 in the same time period of 2014. (38 ▶)

**38 ▶ HOTELS OPENED IN 2015 IN MOSCOW AND THE MOSCOW REGION**

| Name | Number of rooms | Address | Class |
|---|---|---|---|
| | | **Moscow** | |
| Marriott Novy Arbat | 234 | 32 Novy Arbat Street | 5 stars |
| Ibis Moscow Dynamo | 317 | 37/8 Leningradskoe Highway | 3 stars |
| Garden Embassy | 63 | 5 Botanichesky Lane | ND |
| Gorod | 27 | Kazansky railway station | 2 stars |
| Netizen hotel & hostel | 37 | 2 Enthusiastov Boulevard | ND |
| Hampton by Hilton Strogino | 206 | 20 Kulakova Street | 3 stars |
| Palmira Business Club | 228 | 6 Novodanilovskaya Embankment | 4 stars |
| StandArt Hotel | 105 | 2 Strastnoy Boulevard | 5 stars |
| **Total: 8 hotels** | **1,217** | | |
| | | **The Moscow Region** | |
| Amaks Krasnaya Pakhra | 264 | Bldg. 1, 10 Parkovaya Street, Krasnoe village | 3 stars |
| Atelika Sosnovy Bor Country Hotel | 91 | Saburovo village (32 km from MKAD, Schelkovskoe highway) | 2 stars |
| Atelika Lipki Country Hotel | 175 | Lipki village (35 km from MKAD, Mozhaiskoe highway) | 2 stars |
| **Total: 3 hotels** | **530** | | |

Source: EY database, open sources, operators' data

## HOTELS OPENED IN Q1 2015:

• Marriott International announced the opening of Moscow Marriott Novy Arbat hotel on 32 Novy Arbat Street, Moscow, in February 2015. The hotel offers 234 rooms, a lobby-bar, a bar, a restaurant, four conference halls, a banquet hall, a fitness centre, a beauty and hairdresser salon, and a laundry.

• Iris Congress Hotel has been managed by the InterContinental Hotels Group since June 2015. The new name of the hotel located on 10 Korovinskoe Highway is Holiday Inn Moscow-Seligerskaya. The hotel offers 201 rooms, a restaurant, a lobby bar, a café, four conference halls, banquet and ball halls, and a fitness centre with a swimming pool and a sauna.

• The country hotel Sosnovy Bor was taken over by the Atelika hotel chain in February 2015. The hotel located in the village of Saburovo (32 km from MKAD, Schelkovskoe highway), the Moscow region, offers 91 rooms and a cottage, conference halls, meeting rooms, banquet halls, and a fitness and recreation zone with a swimming pool.

• The country hotel Lipki was taken over by the Atelika hotel chain in June 2015. The hotel located in the village of Lipki (35 km from MKAD, Mozhaiskoe highway), Moscow region, offers 175 rooms, a restaurant, two bars, fitness and SPA centres with a swimming pool, a sports ground, a billiard room, a library and a children's club.

## HOTELS OPENED IN Q2 2015:

• Garden Embassy Hotel opened in the MSU Botanic Gardens on 5 Botanichesky Lane, Moscow, in April 2015. The hotel offers 63 rooms, a restaurant, office space, a sports center, a beauty salon, a car-wash and underground parking.

## HOTELS OPENED IN Q3 2015:

• Ibis Moscow Dynamo hotel managed by Accor Hotels opened in Moscow in July 2015. The hotel located on 37/8 Leningradsky Avenue offers 317 rooms, a restaurant, a bar, and five conference halls.

• The mini-hotel Gorod was opened in Moscow at Kazansky railway station in July 2015. The hotel offers 27 rooms, a game room and a library.

• Krasnaya Pakhra resort managed by Amaks Hotels & Resorts opened in the Moscow region in July 2015. The hotel located at bldg. 1, 10 Parkovaya Street in the village of Krasnoe offers 264 rooms, a restaurant, a lobby and phyto bars, a conference hall, a concert hall, a recreational complex with two swimming pools, an open-air sports ground, a pharmaceutical garden and a children's playground.

• The hotel/hostel Netizen was opened in Moscow on 2 Entuziastov Boulevard at the end of September 2015. The hotel offers 37 rooms, a lobby-bar, a lounge zone, fitness equipment and a laundry. The project investment amounted to approximately RUR 400 mln (USD 6.2 mln). The hotel will be part of the Netizen hostel chain which is planned to be developed in Moscow.

## HOTELS OPENED IN Q4 2015:

• Hampton by Hilton Strogino opened under the management of Hilton Worldwide in Moscow at the beginning of November 2015. The hotel is located on 20 Kulakova Street, and offers 206 rooms, a café for breakfast, a lobby bar, three conference halls, a fitness centre and underground parking.

• The Palmira Business Club hotel opened in Moscow on 6 Novodanilovskaya Embankment in the middle of November 2015. The hotel offers 228 rooms, a restaurant, a bar, a conference hall, meeting rooms, a SPA centre and a library.

• The 5-star StandArt hotel opened in Moscow on Strastnoy Boulevard in November 2015. The hotel offers 105 rooms, two restaurants, two bars, a fitness centre with an aquazone, a business centre and parking.

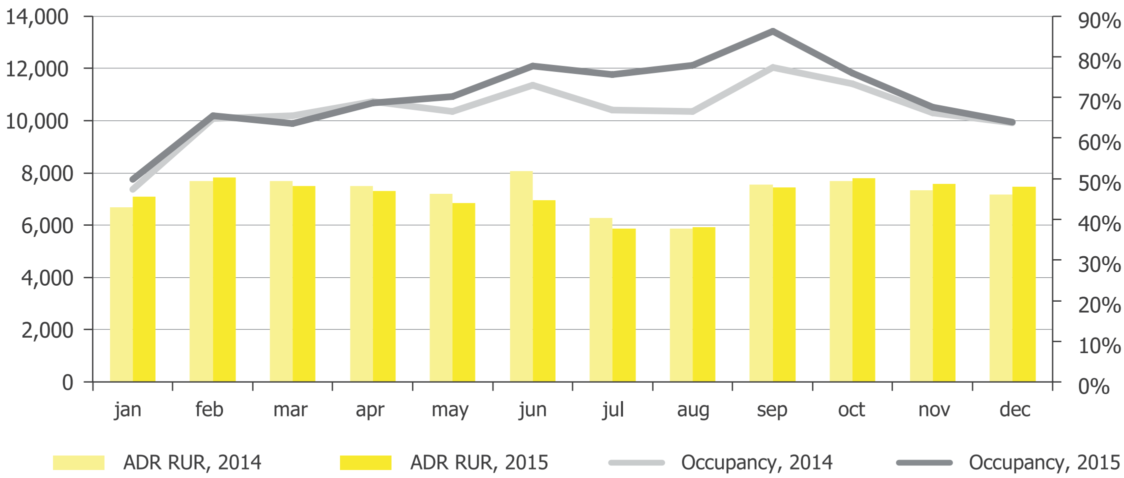
We expect the following hotels to open in 2016: (**39, 40, 41, 42, 43, 44** ▶)

### 39 ▶ FUTURE HOTELS SET TO OPEN IN MOSCOW AND THE MOSCOW REGION IN 2016

| Name | Number of rooms | Address | Class |
|---|---|---|---|
| **Moscow** | | | |
| Holiday Inn Moscow Seligerskaya | 201 | 10 Korovinskoe Highway | 4 stars |
| Adagio Moscow Kievskaya | 150 | Intersection of Kievskaya Street and 2nd Bryansky Lane | 4 stars |
| Ibis Moscow Kievskaya | 300 | Intersection of Kievskaya Street and 2nd Bryansky Lane | 3 stars |
| Novotel Moscow Kievskaya | 250 | Intersection of Kievskaya Street and 2nd Bryansky Lane | 4 stars |
| Ibis Oktyabrskoe Pole | 242 | 2 Marshal Rybalko Street | 3 stars |
| Ibis Budget Oktyabrskoe Pole | 108 | 2 Marshal Rybalko Street | 2 stars |
| Hyatt Regency Moscow Petrovsky Park | 298 | 36 Leningradsky Avenue | 4 stars |
| DoubleTree by Hilton Vnukovo Airport | 432 | Vnukovo Airport | 4 stars |
| Four Points by Sheraton Moscow Vnukovo Airport | 250 | 8 Vnukovskaya Bolshaya Street | 3 stars |
| **The Moscow Region** | | | |
| Ibis Stupino | 120 | Stupino, Pobedy Avenue | 3 stars |

Source: EY database, open sources, operators' data

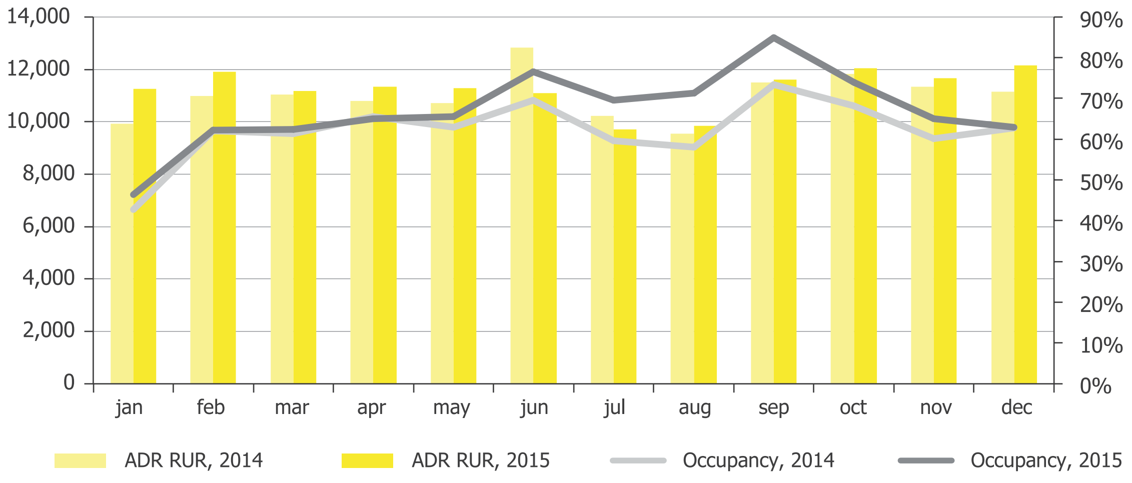
### 40 ▶ AVERAGE MARKET ADR* (RUR) AND OCCUPANCY, 2015 VS. 2014




* Average daily rate

Source: EY analysis

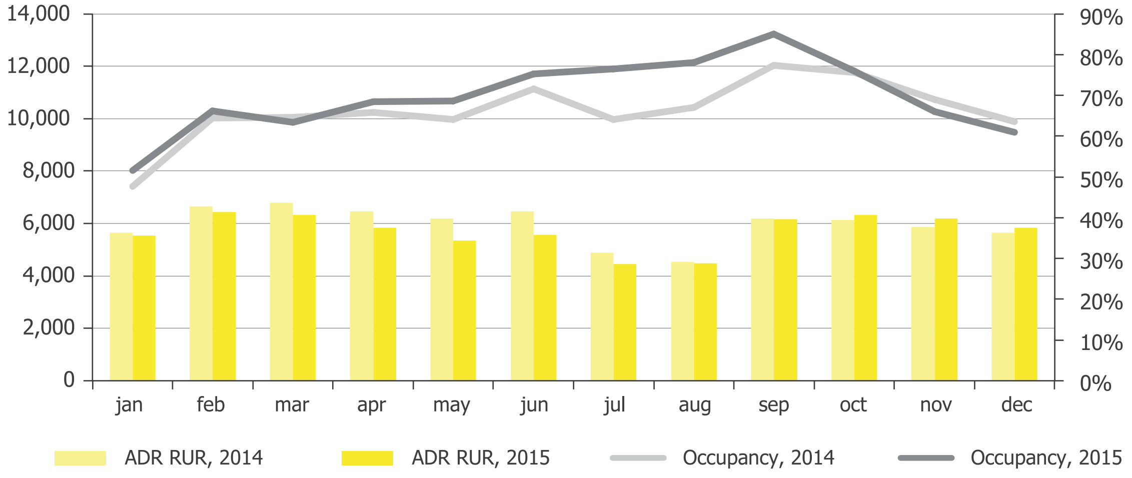
### 41 ▶ 5-STAR HOTELS: ADR* (RUR) AND OCCUPANCY, 2015 VS. 2014




* Average daily rate

Source: EY analysis

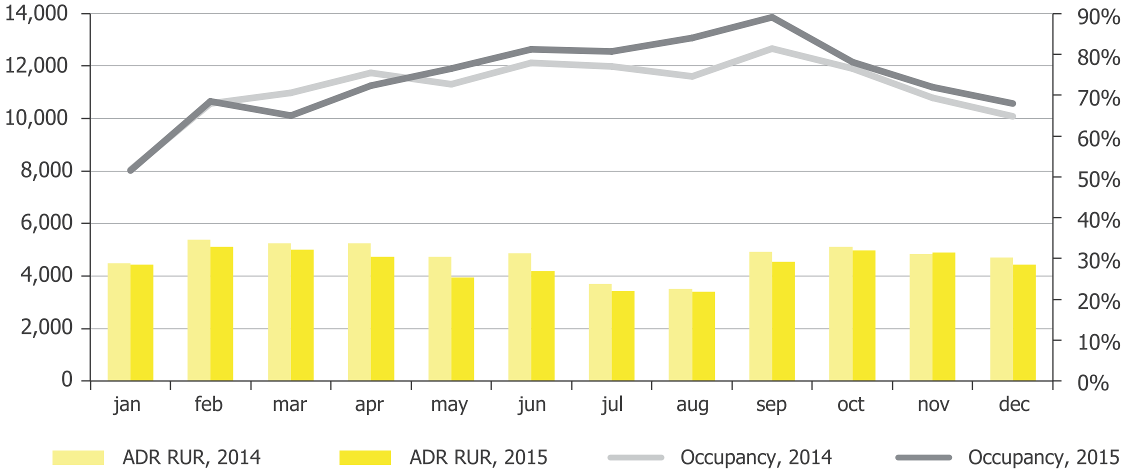
### 42 ▶ 4-STAR HOTELS: ADR* (RUR) AND OCCUPANCY, 2015 VS. 2014




* Average daily rate

Source: EY analysis

## 43 ▶ 3-STAR HOTELS: ADR* (RUR) AND OCCUPANCY, 2015 VS. 2014




* Average daily rate

Source: EY analysis

## 44 ▶ OPERATIONAL INDICES DYNAMICS

| | January–December 2015 (USD/RUR) | January–December 2014 (USD/RUR) | January–December 2015 vs. January–December 2014, %, (USD/RUR) |
|---|---|---|---|
| **5 stars** | | | |
| Occupancy | 67% | 62% | 5% |
| Average daily rate (ADR) | USD 184/RUR 11,258 | USD 285/RUR 10,989 | -36%/2% |
| Revenue per available room (RevPAR) | USD 124/RUR 7,578 | USD 178/RUR 6,871 | -30%/10% |
| **4 stars** | | | |
| Occupancy | 70% | 66% | 3% |
| ADR | USD 93/RUR 5,713 | USD 156/RUR 5,961 | -40 %/-4% |
| RevPAR | USD 65/RUR 3,962 | USD 103/RUR 3,957 | -37 %/0% |
| **3 stars** | | | |
| Occupancy | 74% | 72% | 2% |
| ADR | USD 72/RUR 4,423 | USD 123/RUR 4,731 | -41%/-7% |
| RevPAR | USD 53/RUR 3,245 | USD 88/RUR 3,391 | -40%/-4% |
| **Average** | | | |
| Occupancy | 70% | 67% | 4% |
| ADR | USD 116/RUR 7,131 | USD 188/RUR 7,227 | -38%/-1% |
| RevPAR | USD 81/RUR 4,928 | USD 123/RUR 4,740 | -34%/4% |

Source: Smith Travel Research, EY analysis

# Housing market

The high-budget rental market shifted in 2015 to another stage of development and its participants have fully adopted the new "rules of the game". Primarily, we are talking about the preferred setting of rental rates in roubles, high competition between landlords, market saturation with quality apartments and a decrease in rental rates.

This year was very active for our company and deals were concluded in different price segments. New tenants entered the market and those who had previously rented used the current situation to their own benefit. We conducted a lot of negotiations and moves.

There was a shift in the behavior of owners of high-budget real estate, and the number of deals concluded with the participation of Intermark Relocation in 2015 exceeded 2014.

We expect that, in the coming year rental rates will still be determined by currency fluctuations, but a sharp correction is not expected. In the conservative scenario the number of deals in 2016 will remain at least at the same level... (45 ▶)

## DEMAND

By the end of 2015, demand for high-budget rental apartments had decreased by almost 26%. The reduction is a result of declining tenant interest: demand fell by 30% on average per month until September. From October, Intermark Relocation noted an average monthly increase of 3% (i.e., a demand level similar to the last few months of 2014).

One of the reasons for this reduction was the strong hike in demand in March 2014, the best month in a long time

### 45 ▶ 2015 KEY FIGURES

| | |
|---|---|
| +26% | **Supply remains persistently high**<br>In 2015, Moscow's high-budget rental market recorded consistently high supply levels. Intermark Relocation estimates the vacancy rate of high-budget rental apartments at 26% since the beginning of 2015. |
| 20–25 apartments | **Competition increases among landlords**<br>By year-end, analysts count 20–25 apartments per landlord; a figure comparable with 2008–2009. In the most prosperous years, there were 8–10 apartments per landlord (i.e., half the number). |
| -26% | **Demand declines for high-budget rentals**<br>Demand on the high-budget rental market of Moscow was 26% lower than the previous year. The peak of activity was recorded in April. The slowest months were January and March, when the dollar was strongest against the rouble. |
| -30% | **Average rental budget falls**<br>By the end of 2015, the average rental budget had fallen by almost 30% in dollar terms from 2014. |
| -35% | **Average weighted supply price declines**<br>The current average weighted price of supply in the Moscow high-budget rental market in dollar terms was 35% lower than in 2014 and almost 40% lower than in 2013. |
| ~4% | **Great predictability**<br>The average rental budget became more predictable. In the last few months of 2015, Intermark Relocation recorded minor fluctuations of about 4%. |

Source: Intermark Relocation

for the industry. In March 2015, demand was half that. In 2015, the total number of potential tenant requests had decreased from the previous year.

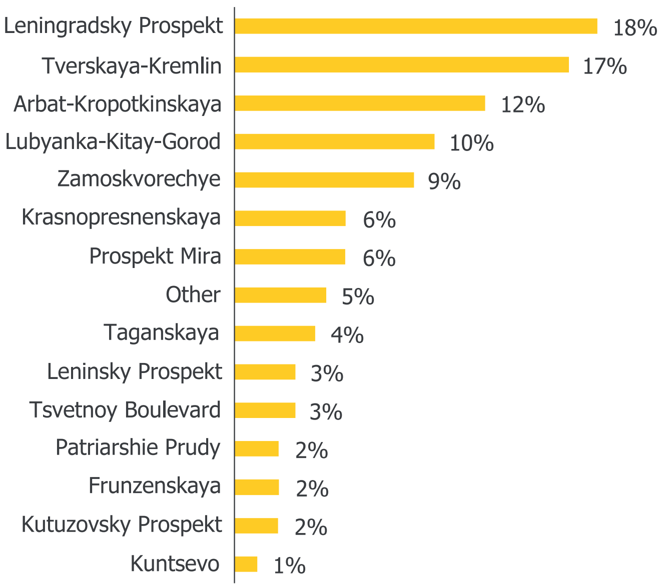
In December, for the first time in a year, the number of deals increased (+20%). November was another relatively good month where the underrun of transactions number from the previous month was only 2%.

The most severe periods of 2015 were January and March, which saw a drop of -40% and -56% respectively from the same months in 2014. The monthly number of requests from potential tenants in 2015 also dropped from 2014.

Demand per location on the high-budget rental market of Moscow barely changed. Leningradsky Prospekt is consistently among the top 3 most popular rental districts in the capital. At the end of 2015, about 18% of potential tenant requests were for property in this location. (46 ▶)

The Tverskaya and Arbat-Kropotkinskaya districts were the second and third most popular, with 17% and 12% of total requests respectively.

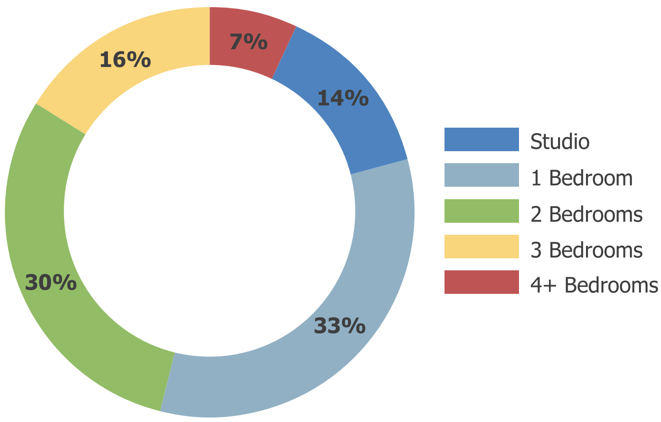
### 46 ▶ MOSCOW RESIDENTIAL DEMAND PER CITY ZONE




Source: Intermark Relocation

Tenant preferences were also stable. Demand for two-bedroom apartments was at the same level as 2014 at about 30% of all requests. To a lesser extent, tenants were interested in compact studio apartments and 3-bedroom apartments (about 15% of requests) as well as spacious apartments with 4+ bedrooms (7%). (47 ▶)

### 47 ▶ DEMAND ANALYSIS OF THE HIGH-BUDGET RESIDENTIAL PROPERTY MARKET IN MOSCOW IN TERMS OF NUMBER OF ROOMS




Source: Intermark Relocation

## SUPPLY

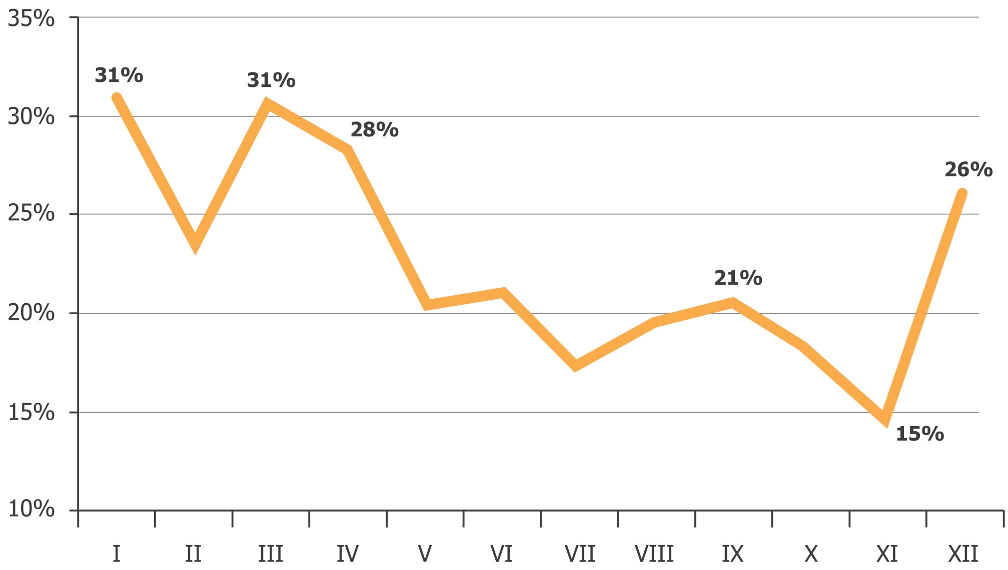
From the beginning of 2015, the supply volume of high-budget residential property rental increased by 26%.

The main influx of new properties was strongest in the first and last few months of the year. By December, this figure had increased by 7% from November – almost one tenth of new apartments entered the market at the end of 2015. Compared to 2014, the biggest monthly increase of supply was observed in early 2015 with peaks in January and March (+31%).

Despite the increased supply over the whole year, Intermark Relocation noted a declining supply (up to +15%) between April and November. However, in December supply increased again. (48 ▶)

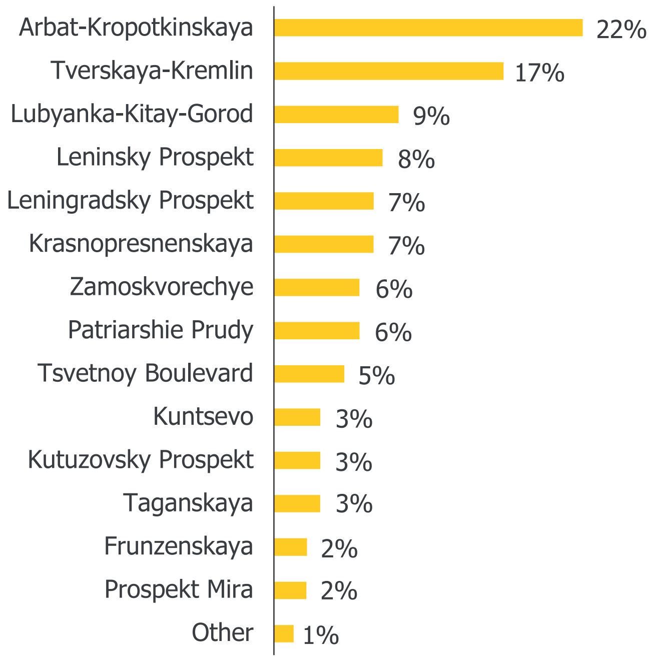
A slightly larger increase was observed in the Tverskaya-Kremlin district: from 13% to 17% of all displayed properties. The maximum supply on the high-budget rental market is still in the Arbat and Kropotkinskaya district: 22% of the total supply, every fifth property. (49 ▶)

### 48 ▶ MOSCOW PRIME RENTAL SUPPLY




Source: Intermark Relocation

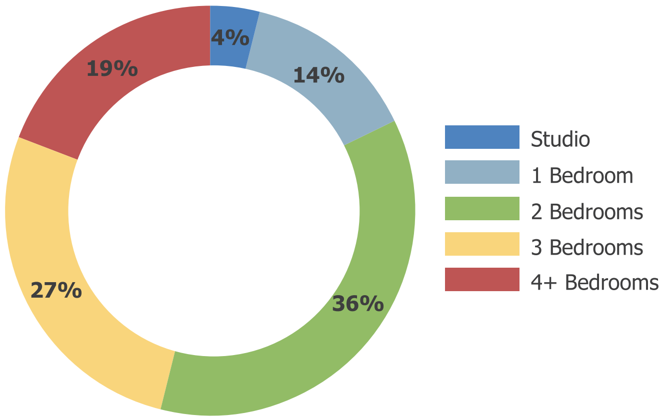
### 49 ▶ MOSCOW RESIDENTIAL SUPPLY PER CITY ZONE




Source: Intermark Relocation

Like in 2014, the supply was dominated by spacious apartments. Properties with 120–150 sq m and 150–200 sq m accounted for 20% and 21% of the supply, respectively. (**50** ▶)

### 50 ▶ SUPPLY ANALYSIS OF THE HIGH-BUDGET RESIDENTIAL PROPERTY IN MOSCOW IN TERMS OF NUMBER OF ROOMS




Source: Intermark Relocation

## BUDGETS AND RATES

• By the end of 2015, the average tenant budget had fallen by almost 30% in dollar terms compared to 2014.

• There was a noticeable reduction of rental rates and budgets in the second half of 2015. By year-end, the average rates and budgets had reached their minimum values.

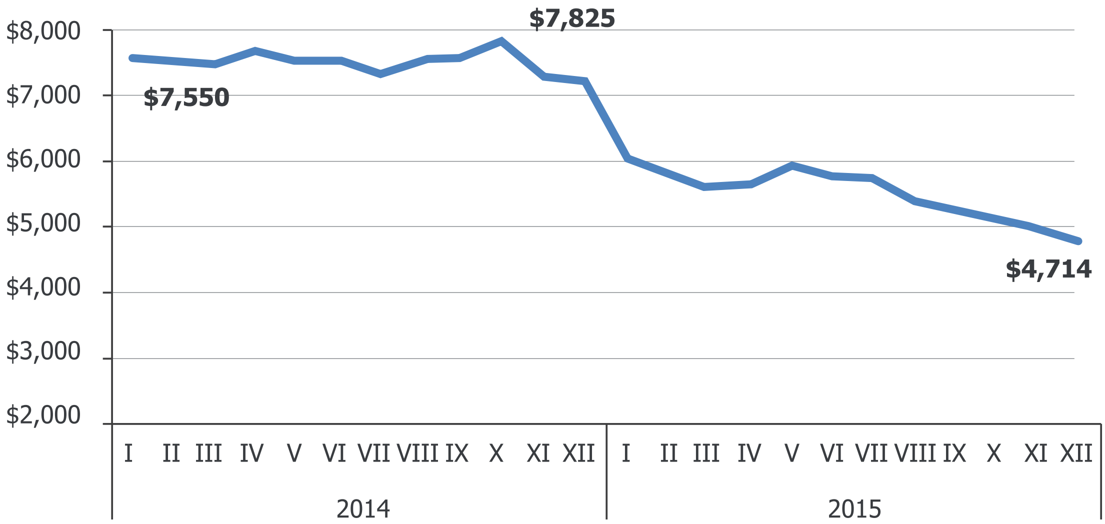
• The weighted average rental rate at the end of December 2015 was USD 4,714 per property per month, which is 35% less than in 2014. This is lower than the average rental rates at the end of 2009.

• The most expensive district is Arbat-Kropotkinskaya, at USD 5,500 per property per month on average. The Krasnopresnensky district is second with an average rate of USD 5,300 per property per month. In third place is Tsvetnoy Boulevard with an average rate of USD 4,730.

• Budgets were more volatile in 2015. From the beginning of the year, there was a decline following the revision of rental rates by landlords. But in the spring of 2015, rates and budgets reached equilibrium.

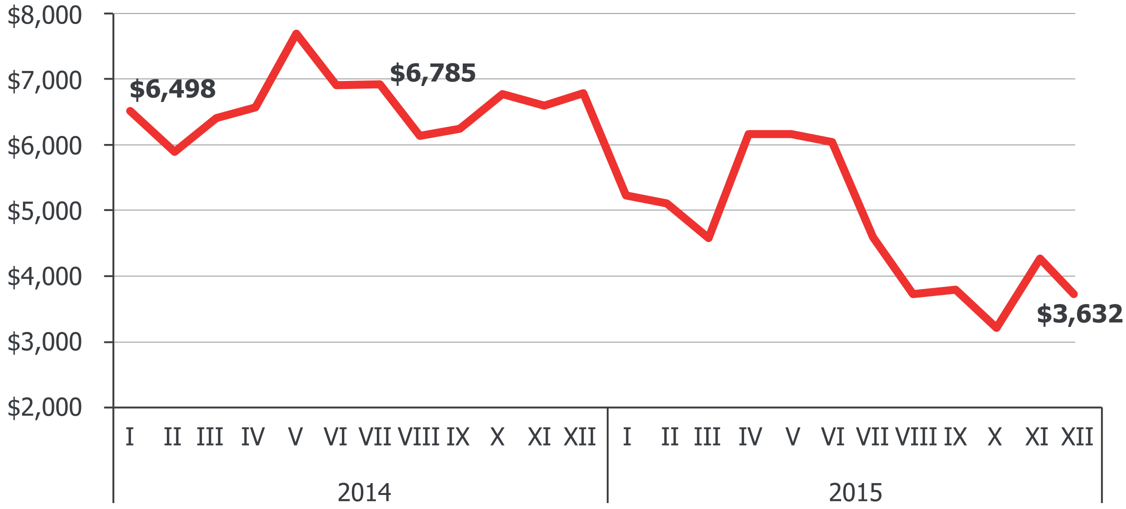
• Following the strengthening of the rouble towards the end of 2015, the most significant change in budgets was on Tverskaya, Arbat and Frunzenskaya streets. To a lesser extent, budgets changed on Leningradsky and Kutuzovsky avenues as well as Tsvetnoy Boulevard. (**51, 52, 53 ▶**)

**51 ▶ AVERAGE BUDGET OF SUPPLY**




Source: Intermark Relocation

## 52 ▶ AVERAGE BUDGET OF DEMAND




Source: Intermark Relocation

## 53 ▶ RENTAL RATE CHANGES IN MOSCOW PER CITY ZONE

| | All market | Arbat-Kro-potkinskaya | Patriarshie Prudy | Tverskaya-Kremlin | Lubyanka, Kitay-Gorod, Chistie Prudy | Zamosk-vorechye | Frunzens-kaya |
|---|---|---|---|---|---|---|---|
| 2014 | USD 6,370 | USD 8,900 | USD 6,760 | USD 6,630 | USD 6,320 | USD 5,770 | USD 6,170 |
| 2015 | USD 4,700 | USD 5,500 | USD 4,470 | USD 3,300 | USD 4,160 | USD 3,900 | USD 2,480 |
| **change, %** | **-26%** | **-38%** | **-34%** | **-50%** | **-34%** | **-32%** | **-60%** |

| | All market | Krasnopresn-enskaya | Tsvetnoy Boulevard | Tagansky | Leningrad-sky Prospect | Kutuzovsky Prospect | Kuntsevo |
|---|---|---|---|---|---|---|---|
| 2014 | USD 6,370 | USD 7,140 | USD 4,920 | USD 3,340 | USD 4,420 | USD 4,930 | USD 4,880 |
| 2015 | USD 4,700 | USD 5,300 | USD 4,730 | USD 2,240 | USD 3,380 | USD 4,440 | USD 4,040 |
| **change, %** | **-26%** | **-26%** | **-4%** | **-33%** | **-24%** | **-10%** | **-17%** |

Source: Intermark Relocation

# St. Petersburg market overview

## Office market

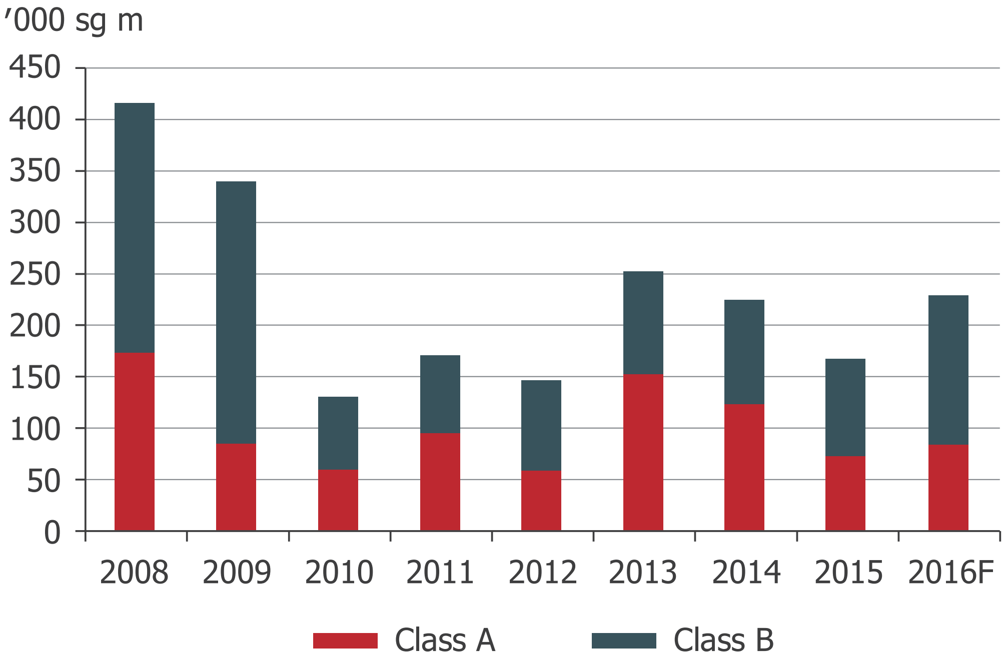
In Q4, the modern office stock (Class A and B) in St. Petersburg increased by 35,700 sq m, with four office buildings delivered to the market. One completed business centre was a Class A building, with a leasable area of 5,200 sq m. The other buildings were Class B, with a total leasable area of 30,530 sq m. The total level of completions in 2015 amounted to 163,000 sq m, which is 26% lower than in 2014. The total level of completions in 2016 is expected to be about 220,000 sq m, due to the fact that a number of business centres were postponed from 2015 to 2016.

The total net absorption in 2015 reached 137,400 sq m, which is 27% lower than in 2014. In Q4, net absorption accounted to 52,500 sq m which is comparable with the average fourth quarter level during the last six years. The proportion of deals concluded in the mining and exploration sector in 2015 decreased by 7 pps to 35%, the first time this has happened since Gazprom began to expand into the St. Petersburg market.

In Q4 2015, the vacancy rate increased by 0.1 pps, reaching 12.2%. In Class A the vacancy rate for the quarter decreased by 1.5 pps to 11.1%, while in Class B it increased by 0.9 pps to 12.9%. For the first time since Q1 2007, the vacancy rate in Class A is inferior to that of Class B.

In Q4 2015, Class A rental rates decreased by 2.1%, with Class B rates dropping by 1.6%. During the year the decline amounted to 6.6% and 5.7% respectively. In Q4, the average asking rouble rental rate amounted to RUR 1,560 per sq m/month in Class A and RUR 1,120 per sq m/month in Class B (including VAT and operating expenses). (**54** ▶)

**54 ▶ OFFICE COMPLETIONS**




Source: JLL

# Retail market

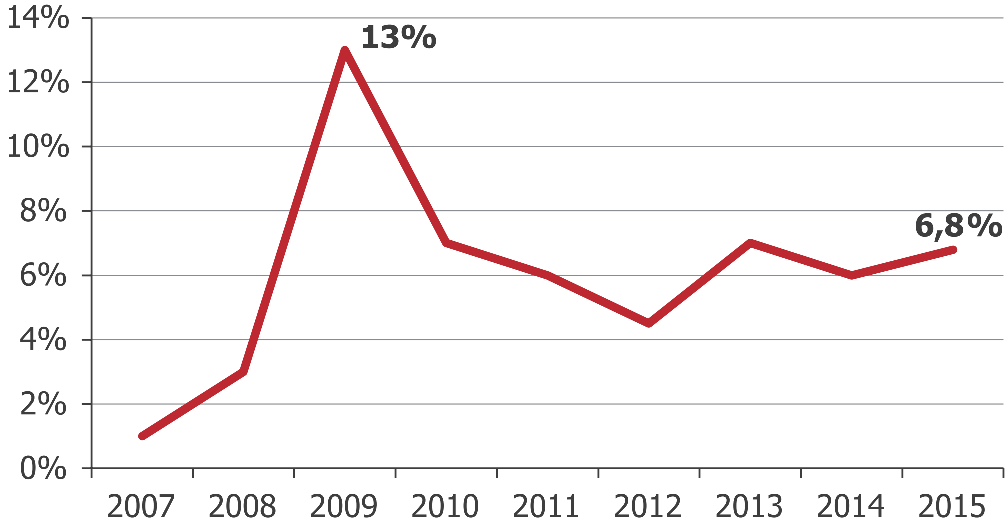
Two shopping centres was opened in Q4 – the second phase of Piter-Raduga SEC (GLA – 29,000 sq m) and the first phase of the first outlet centre in St. Petersburg Outlet Village Pulkovo (GLA – 14,700 sq m). So total SC completions in 2015 amounted to 43,700 sq m, which is the lowest since 2010.

At the end of 2015, the retail market vacancy rate amounted to 6.8%. It increased by 0.2 pps in Q4 and by 0.8 pps for the full year. In 2016, vacancy rates in the St. Petersburg retail market will continue to increase up to 7.5–8.0%.

In January–November 2015, real income decreased by 5.8% YoY. Retail turnover and wholesale turnover decreased from January–November 2015 by 11.3% and 15.0% respectively. Restaurant turnover fell by 5.0% in the same time period.

The total volume of premises opened (excluding new shopping centres) in Q4 2015 exceeds the amount of premises closed by 25%. In Q4 2015, the clothing, shoes and accessories sector dominated in the breakdown of premises opened (45% of premises opened were in the fashion sector), because shopping centres that were delivered to the market this year were mainly focused on fashion retailers. In Q4, more than half of the premises closed belonged to fashion retailers, but a smaller proportion of premises opened were by fashion retailers. In absolute figures the number of fashion retailers opened was more than the number of fashion retailers closed (34,300 sq m vs 21,900 sq m). (**55 ▶**)

**55 ▶ VACANCY RATE IN SHOPPING CENTRES**




Source: JLL

# Street-retail market

The proportion of street retail premises opened and closed in Q4 turned out to be balanced for the first time in 2015. The proportion of fashion retailers in the breakdown of opened vs. closed premises was about 20%, and more fashion shops were opened than closed. In general, in Q4 the bulk of all premises opened of all types exceeded the number of premises closed by 30%.

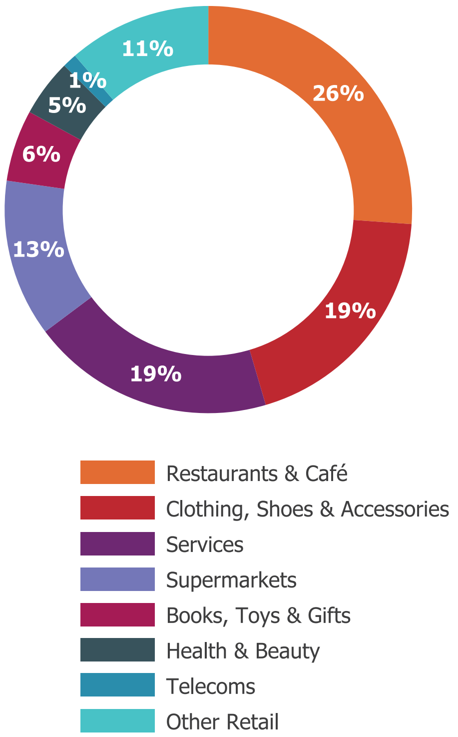
The proportion of the vacant space in the main street retail corridors in St. Petersburg continued to decline and by the end of Q4 reached 6.7%, having decreased in October–December by 1.5 pps. The most significant decrease was observed on Sadovaya str., where during the quarter the vacancy rate decreased from 15.7% to 8.8%.

Rental rates increased slightly due to the recovery of demand and the vacancy rate reduction in St. Petersburg street retail corridors. The upper rental rate level increased by 8–10% on Vladimirsky and Moskovsky prospekt and on Bolshaya Konyushennaya street. Prime rental rates (typical for Nevsky prospekt) remained at the same level and amount to RUR 12,500 per sq m/month (including VAT).

Rotation on the main street retail corridors in Q4 2015 was equal to 7.6%. So the last three months of the year were some of the most active in terms of changing tenants in street retail corridors, exceeded only in Q2 when rotation reached 9.3%. As a result, 26.2% of all tenants on the central street retail corridors were replaced from the end of 2014.

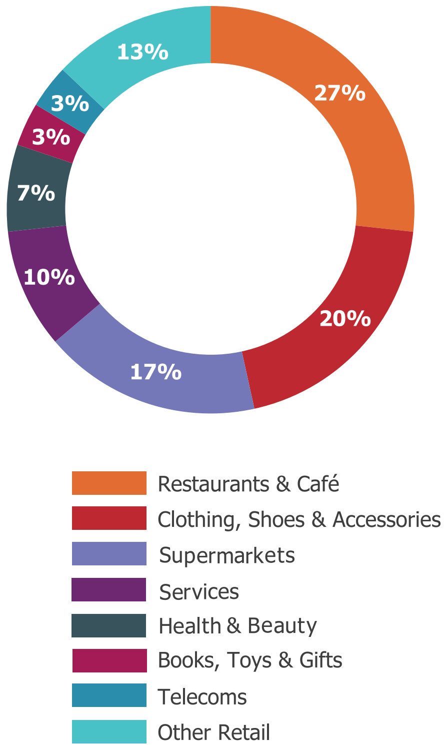
In Q4, the highest rotation was observed on Vladimirsky prospekt, Sadovaya str., and 6–7 lines V.O. and reached 17.9%, 12.1% and 10.3%, respectively. (56, 57 ▶)

**56 ▶ PREMISES CLOSED IN Q4 2015 BY RETAIL PROFILE (NUMBER OF RETAIL UNITS)**




Source: JLL

**57 ▶ PREMISES OPENED IN Q4 2015 BY RETAIL PROFILE (NUMBER OF RETAIL UNITS)**




Source: JLL

# Warehouse market

In Q4 2015, six quality warehouse complexes were delivered to the market with a total area of more than 75,000 sq m. In total, in 2015, 137,000 sq m of quality warehouse space emerged in the St. Petersburg market, with around 15% space being speculative warehouse space (20,000 sq m). More than 300,000 sq m is scheduled for commissioning in 2016.

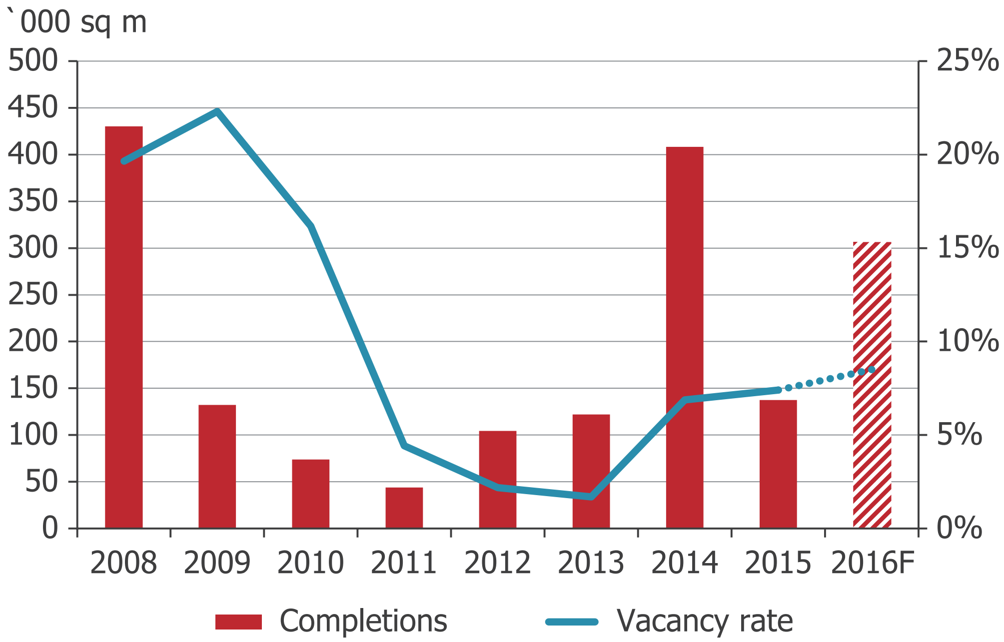
The total take-up of completed deals in Q1–Q4 2015 reached 276,100 sq m, which is 29% lower than in the same time period last year (389,500 sq m in 2014). In Q4 2015, 33% of all deals were concluded.

By the end of 2015, net absorption reached 118,300 sq m, which is the lowest level in the last five years. The proportion of net absorption in Q4 2015 was around 40% (46,500 sq m).

Retail companies were leaders in terms of demand with 43% of the total leased volume in 2015. In comparison to 2014, distribution and manufacturing companies showed higher activity in 2015 (22% and 21% of all deals respectively). The proportion of logistic companies was 11%.

In the fourth quarter of 2015, the vacancy rate increased by 1 pps to 7.4%. Overall, in 2015 the vacancy rate grew by 0.5 pps. The asking rental rates were USD 45–50/sq m/year (without OpEx[1] and VAT). (58 ▶)

**58 ▶ COMPLETIONS AND VACANCY RATES IN THE WAREHOUSE MARKET**




[1] Operational expenses

Source: JLL

**Hot Topic:**

# Russian Real estate laws: key changes in 2015

**Ekaterina Lapidus**
**Partner, Real Estate and Construction Practice, BRANDI PARTNERS**

**Olga Ezhova**
**Senior Associate, Real Estate and Construction Practice, BRANDI PARTNERS**

In 2015, the RF real estate, construction and land legislation saw major changes affecting the interests of many players in the commercial real estate market in Russia. This article looks at some of the key changes in this context.

## NEW DOCTRINES AND CONCEPTS IN THE RF CIVIL CODE

On 1 June 2015, fundamental changes to the RF Civil Code took effect[1] ("RF CC"). Many of the changes are progressive in nature and meet the requirements of Russian business practices. Such changes include, first and foremost, the doctrines of "representations" and "indemnities", which are brand-new for Russian law. Previously, such safeguards could only be used in contracts subject to foreign (normally, English) law. Now, however, having incorporated the new doctrines into their contract, market players will be able to structure their purchases and sales of assets under Russian law as well, with certain guarantees in place against possible "defects" in the asset. Also of importance is the roll-out of the concept of "pre-contractual liability", previously unknown in Russian law. Market participants must now be more attentive and thorough in strategising their negotiations – lest they incur liability for a breach of the new statutes.

## OTHER IMPORTANT CHANGES TO THE RF CIVIL CODE

Other important amendments to the RF CC that came into force on 1 June 2015 are the statutory option of including discretionary terms and conditions in the contract; the option of stipulating an exit charge for the contract; the definition of a security deposit as a performance bond; the introduction of independent guarantees, which can be issued by non-lenders; clauses limiting the options for suing for contract voidance. The above changes offer commercial real estate market players certain guarantees and more options for better structuring their arrangements with counterparties.

## SWEEPING CHANGES TO RF LAND LEGISLATION

Sweeping amendments to the RF Land Code came into effect on 1 March 2015[2]. Real estate market players (investors, property developers and building contractors) that bid for public land for development purposes were hit the hardest by the changes. The key changes include: a basic requirement that public land be auctioned off and normally as leasehold only; a statutory range of lease terms for public land; no first refusal for public land tenants on a new lease.

[1] Enacted by Federal Law No. 42-FL dated 8 March 2015

[2] Pursuant to Federal Law No. 171-FL dated 23 June 2014

Thus, the acquisition and use of federal, state and municipal land is now subject to closer (and, in a certain sense, stricter) regulatory control, which real estate market players should be aware of when contemplating the acquisition and use of public land for development.

In addition, 1 April 2015 is the effective date of the federal law[3] governing the seizure of land for federal, state or municipal use, which also reduces the duration of seizure from 1 year to 3 months. In light of the amendments enacted, landholders are recommended to closely monitor the government plans pertaining to the construction and refurbishment of federal, state and local properties, in order to be able to lodge their objections and criticisms in good time and contest the government seizure of land.

## CHANGES TO UNAUTHORISED CONSTRUCTION REGULATION

On 1 September 2015, a federal law[4] came into force that overhauled the regulations on unauthorised construction. Specifically, it changed the definition of unauthorised construction, ratcheted up the requirements for the recognition of titles to unauthorised construction, and for certain situations introduced an extrajudicial (administrative) procedure for demolishing an unauthorised construction site. The amendments enacted make it much harder for a property developer to register his or her title to unauthorised construction.

## CHANGES RELATED TO THE NOTARISATION OF REAL ESTATE TRANSACTIONS

On 1 January 2015, a federal law[5] came into force that enacted important changes to the notarisation of real estate transactions. Specifically, it slashed the notarial rates for the certification of property conveyances. It also reduced the lead time for the public registration of property titles and transactions based on notarised documents (the new time limit is just 3 working days, or just 1 working day for documents filed in electronic format and an application filed by a public notary in electronic format). Special evidentiary effect has been given to a notarial document – it is now far more difficult to challenge a notarised real estate transaction. Thus, real estate market players can use notarisation to slash the time needed to register their deal, and to safeguard it from challenges.

## REFORM OF THE NATIONAL PROPERTY REGISTRATION SYSTEM

13 July 2015 saw the adoption of Federal Law No. 218-FL, "On national property registration". The law reforms the national property registration system by providing for a merger between the national register of titles (Unified Public Register of Real Property Titles and Transactions) and the national cadastre effective as of 1 January 2017. Thus, it puts in place an integrated federal system of national title registration and national cadastral registration. The changes will mitigate investment risks and reduce the costs of titling. I.e., the current procedure requires that the registration of title to a new property be preceded by cadastral registration thereof, while from 1 January 2017 it will no longer be necessary to complete two consecutive registration steps.

## MILESTONE PRECEDENT

Last but not least is the establishment in late 2015 of an important, even extraordinary, legal precedent for amending a lease contract with a USD rental rate. Note that previously the court denied virtually every claim by tenants to terminate or amend a lease contract under art. 451 of the RF Civil Code on the grounds that a dramatic weakening of the rouble does not constitute, in and of itself, a material change in circumstances giving cause to amend or terminate a contract. At the end of 2015, however, the media reported a precedent (case No. A40-83845/2015 in the action brought by Vimpelcom), with the Arbitrazh (Commercial) Court of Moscow ruling the move to a floating rouble exchange rate by the RF financial authorities, which caused a depreciation of the Russian currency, to be good and sufficient cause to amend a lease contract with a USD rental rate by means of determining the upper and lower limits of a USD rate for calculation of rental payments in the contract. Note that although the court has not yet published the rationale for its judgment, it is a milestone per se, since it constitutes a sort of "U-turn" in the treatment of the matter by judges.

[3] Federal Law No. 499-FL dated 31 December 2014

[4] Federal Law No. 258-FL dated 13 July 2015

[5] Federal Law No. 457-FL dated 29 December 2014

**Hot Topic:**

# Time to upgrade your warehousing or manufacturing footprint in Russia? Do not let a good crisis go to waste!

**Christopher Van Riet**
**Managing Director, Radius Group**

The depth and severity of the current crisis in the Russian economy has hit companies hard, causing many international players to reevaluate their Russia strategy. Some have elected to slim down their retail networks and scale down their expansion plans, or to drastically reduce their presence in the country.

Other multinationals, however, see today's tough conditions as a strategic opportunity. Over the last year, the real-estate infrastructure companies need in order to serve Russian markets has become dramatically cheaper and more accessible. As speculative real-estate construction projects started before the crisis emerged, they have struggled to find tenants.

For the warehouse and logistics real-estate sector, vacancy rates in the Moscow area have risen to over 10%, their highest since 2009 and a dramatic shift in a region with a structural shortage of industrial space. In 2012 and 2013, vacancy rates in the area hovered below 2%, and developers could not build fast enough to meet demand. Today the vacancy level in Moscow is over 800,000 m$^2$, the highest in the history for the region. As a result, rents have fallen by over 30%, well below levels recorded during the 2008 financial crisis. Companies looking for manufacturing or distribution space can currently rent premises at rates lower than those necessary to stimulate the construction sector to build new facilities.

The current state of the real-estate markets creates significant opportunities for companies operating in Russia. This is especially true for companies looking to develop the sophisticated supply chain infrastructure that modern markets and efficient operations require. The nature of those opportunities depends on the organisation's chosen response to the economic crisis:

## MAINTAIN FUNCTIONALITY WHILE REDUCING FIXED COSTS

Tough market conditions mean companies with existing facilities in Russia have been able to renegotiate leases on favorable terms, or to take advantage of additional capacity in the market – and commercial flexibility – to reconfigure their operational footprints to better suit their current and anticipated future needs.

As part of its restructuring efforts in Russia, one global sporting goods firm has purchased outright the distribution center in the South of Moscow that it had previously leased. The company was able to acquire the building at a relatively low price from a landlord in need of capital, a less costly option for the sportswear company than its previous US dollar denominated long-term lease contract.

## UPGRADE EXISTING REAL ESTATE INFRASTRUCTURE AT HISTORICALLY LOW RENTAL VALUES

Companies are looking for operational efficiency improvements as well as cost reductions in order to maintain the profitability of their Russian operations. High quality, well designed and energy efficient warehouses and manufacturing facilities have an important role to play here, and some companies are taking advantage of lower real-estate costs to shift their activities to better premises.

Low rents, flexible lease arrangements and the availability of long term leases denominated in roubles rather than dollars mean that such upgrades can often be made on more favourable terms than those in place for older, less appropriate facilities.

## EXPAND FUNCTIONALITY AND IMPROVE OPERATIONAL EFFICIENCY AT HISTORICALLY LOW INVESTMENT COSTS

Some companies, particularly ambitious retail players, are accelerating their investment and expansion plans, using the crisis to secure new property at costs that would have been unthinkable before the crisis.

One European retail chain invested EUR 138 million in Russia during 2015, for example, and has announced plans to invest a further EUR 195 million (RUR 18 billion) in 2016 to build 10 new hypermarkets and 40 new supermarkets in Russia, together with the associated supply chain infrastructure. The company also has plans to build a new 100,000 $m^2$ distribution center, scheduled to open in 2018.

## MAXIMISING RETURN – QUALITY AND COMPLIANCE ARE KEY

Whatever the business case for making changes to a Russia supply chain footprint, some key considerations will help companies to achieve the best long-term value from the decisions they make today.

Even around Moscow, Russia's industrial property markets remain relatively immature. Moreover, the high cost of capital puts pressure on the margins of property developers, leading many to emphasise low construction costs over longevity, operating performance, or even legal and regulatory compliance of buildings.

As a result, international companies – especially those looking for class A accommodation built to international standards and owned by reliable landlords – can still find it difficult to access the property they need. Detailed due diligence is essential, therefore, and this should include not only the construction and condition of buildings, but also the quality and availability of utilities and the business practices of developers and landlords.

If an organisation cannot meet its needs from existing stock yet has access to the appropriate capital, the crisis has also created extremely favorable conditions for new construction projects. Thanks to the devalued rouble and the dramatic slowdown in investment, land and construction costs have fallen significantly for international firms. At USD 550 per $m^2$, quality construction costs (excluding land, infrastructure and pre-development costs) for large distribution facilities in the Moscow area are now around 40 percent cheaper than similar facilities in the US, for example[1].

Property development in Russia comes with its own challenges, however, which should not be underestimated. Key considerations include securing the utility supply, development permissions and construction permits for connecting all necessary utilities to the land site; managing the cost and timing of establishing such utility connections, and ensuring a reliable, cost effective long-term utility supply. In addition, it can be hard to ensure – and document – compliance with appropriate fire safety, security and environmental performance standards, especially when working with contractors unfamiliar with internationally accepted construction practices.

For companies looking for build-to-suit accommodation, a growing understanding of the requirements of international customers has produced a new breed of property developers able to deliver high-quality properties. Demand for such properties has also been driven by investors, who understand that a longer lasting, higher value asset is a safer investment warranting a lower return on capital. For tenants, that means lower rents, lower operating costs, lower energy consumption and lower maintenance costs while enjoying the greater operating efficiencies that high-quality facilities provide.

Today's tough economic conditions represent a significant opportunity for companies with a long-term commitment to Russia. Cost reductions and an easing of capacity constraints have created a unique window of opportunity to acquire industrial real-estate in a market that more commonly suffers severe supply shortages. Quality remains an issue, with a lack of familiarity with international construction standards and business norms, but with suitable diligence in the selection of sites, landlords and development partners, leading companies are taking advantage of the crisis to acquire high quality supply chain assets to support their ambitions for the Russian market.

[1] From Turner and Townsend International Construction Survey 2015, comparing Moscow Page 50, with US Seattle page 68 (USD 960/$m^2$)

**Hot Topic:**

# Quality service by a private maintenance company as a tool to increase sales

**Alexander Arsenyev**
**Vice President,**
**Head of YIT Services Russia,**
**Housing Russia, YIT**

There was a drop in sales in the Russian residential real estate market in 2015. In Moscow alone, where traditionally the demand for real estate is at a higher level than in other regions across the country, the number of deals in the primary market fell by more than 18%.

In this context, competition among developers for consumers is growing. It is obvious that the days when the market sold absolutely any product have passed. Today, buyers have a more sensible approach when choosing a developer and project. And the price is not the determining factor for the buyer. The qualitative characteristics of the project, the level of customer service and even the after-sales service have become the most important factors.

The ongoing maintenance and management of the housing stock is one of the most problematic areas in the Russian real estate market today. Not all tenants are informed about what organisation maintains their buulding, which functions it should perform and what rights and responsibilities the residents have.

Today, one of the main forms of apartment building maintenance in Russia is a homeowner association, which manages the building, either alone or by hiring a maintenance company. However, many residents consider such a form of management a burden rather than an advantage. It can really be a problem in the case of a dilapidated housing stock that requires major repairs. In the case of new housing, this format is quite effective if its work is properly organised.

For comparison, let us take a look at the experience of neighbouring Finland, which has implemented a unique model regarding the relationship between the owners of a property, the management company and service organisations. As the main form of management of an apartment building, the Finns have the housing Joint Stock Company (HJSC) with its charter, board of directors and budget. In this aspect, HJSCs resemble Russian homeowner associations. But the main difference is that the HJSC charter – the set of rules for living in each building, is strictly observed, the board of directors does not play only a formal role and it really works and represents the interests of the stakeholders – the tenants. In addition, the budget is spent transparently and effectively.

In Finland, maintenance companies that are hired by HJSC boards of directors perform the direct maintenance of residential buildings. And the activities of these operating


companies are not regulated by the state; they operate according to market laws and regulations under conditions of fierce competition. As a result, the quality of the services is incredibly high, and the pricing is very flexible. After all, if the service does not live up to the expectations of the tenants, the contract with the management company will be dissolved, and a competing organisation will be recruited.

Meanwhile, the demand for quality maintenance companies working according to European standards is currently growing in Russia as well: this means not only the provision of a comfortable living space inside the private apartment but also the quality maintenance of staircases, entrances and adjacent areas within the territory of the building.

One mechanism for the implementation of high-quality after-sale services for a developer is to create a private maintenance company. This model provides a number of benefits to residents of a building. Firstly, a private maintenance company possesses complete information about the utilities and technological aspects of the building, and it has the ability to maintain the building in full compliance with regulations and instructions. Secondly, such a maintenance company can begin to perform building maintenance immediately after the residents move into the building. In the case of an external company, it takes a long time to select one. After that, the new company needs some time to become familiar with the building and to regulate the workflows. Finally, a private maintenance company has the ability to set a reasonable price for their services and issue a guarantee for them.

More and more real estate development companies operating in Russia are choosing to operate in this way. Many of them create a working model of their private maintenance companies according to foreign models. But most importantly, they should take into account possible reputational risks. Understanding that poor service will inevitably have a negative impact on the image of the developer must be an incentive for the continuous improvement of the quality of services. Now, in times of crisis and with the drop in the number of deals in the real estate market, providing a high level of service can be an important competitive advantage for a project at the selling stage.

**Hot Topic:**

# Sustainability as a result of energy efficiency and greenbuilding measures, but not only that

**Gerald Sakuler**
**DGNB Consultant**

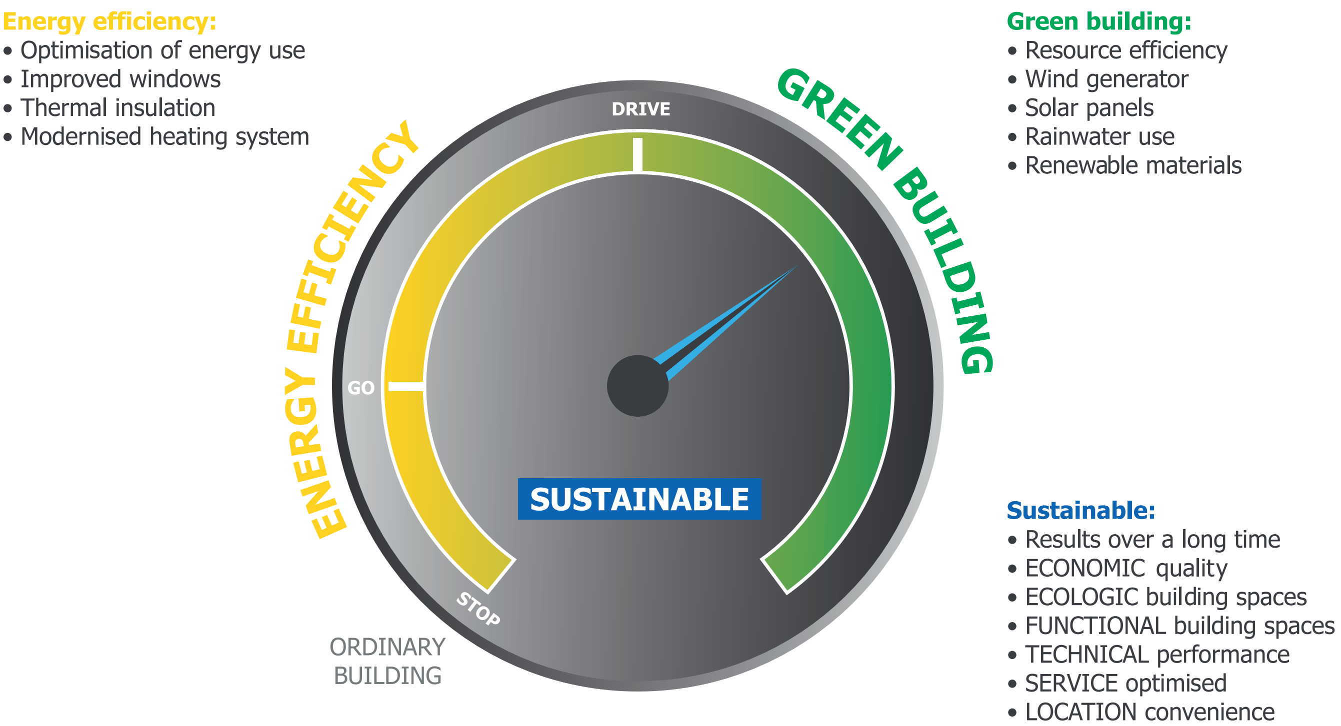
For several years now discussions have been ongoing about the various certification systems for eco-buildings and improvements to their environmental performance. But is it clear enough how this is all interconnected? Energy efficiency, greenbuilding and sustainability – or in other words Leed, Breem and DGNB, to name a few. How is it all related? A simple example may explain it:

It is similar to the information that is given by a tachometer in a car. Three types of information are given which are interconnected but completely different. You can see if you are moving or at a standstill, you can see how fast you are driving and you see how many kilometres you have done. Moving or being at a standstill is stop and go information, how fast you are driving is speed in kilometres per hour, and both is information about what you are doing at this very moment. The third type of information is how far you have driven and this is a distance rating in kilometres done in a certain period of time. Three completely different measurements which are different but related. At the end the tachometer shows the measurements taken:
1) the measures taken to make the car move;
2) the measures taken to make the car go fast; and
3) the measures taken to make the car drive a large number of kilometres.

This can be compared with energy efficiency, greenbuilding and sustainability certification systems. The energy efficiency rating rates the measures taken in a building to save energy, such as thermal insulation and better technical equipment from HVAC to lights. The greenbuilding rating rates how many non-renewable resources have been replaced by renewable resources such as rainwater recycled materials, solar and wind energy. The sustainability rating does not rate the measures taken but the results gained over a period of time, so the sustainability rating shows if the energy efficiency and greenbuilding measures have had an effect in the long-term during the whole lifecycle of a building in terms of ecological performance. But this is not only a rating of energy efficiency and greenbuilding – in the long-term additional measures are considered and rated, as the longer a building is in operation the more resources are saved and the smaller the impact is on the environment.

It all sounds complicated, but looking at it in more detail it becomes quite clear what needs to be done for a building that is in operation for a long time to be accepted by its users, its owner and the public: the building must be constructed to the highest technical quality, be functional, comfortable, have good indoor air quality and lighting, a pleasant design/style, a low impact on the surrounding neighbourhood, accessibility and easy access to public transport, and so forth. But, and this may be a surprise – the economic performance is also rated as a building that is not profitable would not be kept for long and this is a limitation that makes sense to all the measures taken, because a more expensive building would not receive a sustainability certificate. It could, however, receive an energy efficiency or greenbuilding certificate.

The sustainability rating system is the DGNB (Das Guetesiegel fuer Nachhaltige Bauten) system and the organisation that maintains the system and approves the awards is also called DGNB. It monitors the life-cycle




impact of a building on the environment in 6 main chapters:

- Site quality/location/accessibility
- Ecological quality/materials/energy
- Technical quality/solutions/features
- Process quality/maintenance programme
- Socio-cultural acceptability/comfort/health impact
- Economic performance/profitability

Sustainability is defined in the European standard EN TC 350, and the most popular words connected with it are LCA and LCC. Life Cycle Assessment and Life Cycle Cost, and also the Environmental Product Declaration (EPD) for materials play an important role in this modern construction standard and all this is available with international certification and local certificates.

On the product level and on the level of the entire building there are certificates approved by corporate bodies, local/domestic councils and international councils. The international ones are the most challenging, but these are the only ones which do not require any further verification, while all others do if such certificates are required in international business relations or when companies have in their strategy a corporate social responsibility chapter.

A company may implement the standards first via a corporate programme, then through domestic programmes and finally through international certification, making the steps taken manageable.

As the weak rouble stimulates the export of building materials to Europe, Russian manufacturers have become more interested in internationally approved EPDs.

In any case it is always important to understand what a certificate certifies, however impressive its name may be or however well it is presented, because development in this field was so fast that it required a degree of trial and error, which caused confusion and sometimes overlaps until the clarity we see today was reached. In general, all these certificates attest to a greater focus on the environment. Some relate only to certain aspects of environmental performance while the sustainability certificate attests to the general performance and quality of a building, and the Environmental Product Declaration attests to the environmental performance of the materials used in the building.

Association of European Businesses

## AEB REAL ESTATE COMMITTEE

The AEB Real Estate Committee was founded in 2003 and brings together real estate professionals from a variety of areas including developers, investors, financiers, consultants, project and facilities managers, and other service providers.

The Real Estate Committee has three primary objectives around which its activities are structured: to facilitate the exchange of information regarding real estate and development issues in Russia; to influence existing procedures in order to increase the attractiveness of foreign and domestic investment; and to establish a "bridge" between the AEB, the Moscow Government, State Duma and other relevant governmental bodies.

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