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CAPITAL · OFFICE · RETAIL · WAREHOUSE · HOSPITALITY · HOUSING

Contents

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Tadzio Schilling
Chief Executive Officer,
Association of European Businesses

Dear readers,

Let me kindly welcome you at the start of a new business season!

It is going to be different this time, as long-term consequences of the COVID-19 pandemic will apparently affect companies' strategies and operations till the end of the year.

Nevertheless, we hope for a step-by-step resumption of business activities in the months to come. For our part, we will make every effort to open up new avenues for offering top-quality services to our members.

The AEB has worked at full capacity during the whole period of the coronavirus outbreak, that equally refers to production of publications.

With genuine pleasure I would like to present the third in 2020 issue of the "Real Estate Monitor" to you.

It provides a broadly illustrated overview of the Moscow and St. Petersburg markets in the second quarter of 2020, and accumulates data for the first half of the year.

A sharp drop in investment volume, the lowest ever number of international brands which entered the Russian market, the highest since 2009 level of supply of prime apartments, a tremendous fall in the hotels' average occupancy (by 41%) – these are a few of the most obvious outcomes caused by the COVID-19 crisis.

As for the hot topics, they traditionally cover a wide range of issues: the existing gaps in legal acts regulating rental relationships under pandemic circumstances; the inevitable transformation of the 'workplace' concept in response to the coronavirus outbreak; the court practice regarding real estate lease agreements when a lessee refuses to accept the rented property; the legislative requirements on operating gas networks and boiler houses.

Dear friends, the upcoming business season will be remarkable as we are going to celebrate the AEB 25th anniversary. The epidemiological situation has impacted the ceremony scenario, nevertheless we will try to turn the celebration into a magnificent festival of smart ideas and advanced solutions looking to the future. I would like to take this opportunity to invite you all to join us in sharing valuable experiences and outstanding achievements. Let us grow strong together!

And in the meantime, enjoy your reading!

Tatjana Kovalenko
Chairperson of the AEB Real Estate Committee, Deputy General Director, SENDLER & COMPANY

Dear readers,

Russia has been successful in mitigating the impacts of the pandemic. However, structural problems in the economy will restrict the speed of post-COVID-19 recovery.

The residential market remains strong. In Russia, the housing sector has a rather archaic institutional structure. There is a limited range of housing options, a poor variety of architectural and urban planning projects, and a weak penetration of new technologies. This archaism is slowly transforming and being overcome, largely due to the COVID-19 crisis and the search for new living situations, such as coliving.

The flexible workspace is one of the few segments that has effectively adapted to this new normal. The work-from-home experience has accelerated the development of a workplace ecosystem. This shift to balancing office, home and remote working raises a pertinent question: will the office remain a critical driver of culture, learning and personal connection?

In spring of 2020, e-commerce had a strong impetus for development. The volume of global e-commerce has grown significantly. While the growth rate of online retail in Russia is still lagging behind, if Russian marketplaces are able to consolidate the success achieved during the pandemic and retain its share in retail turnover after the restrictions are lifted, online trade will advance to a new stage.

Compared to other commercial real estate sectors, the warehouse sector was less affected by the shock brought by the pandemic.

Overall, the property market has two things going for it, even in these rapidly changing times.

The first is that properties may still be a wise investment, even if prices fall. Property is a particularly reliable and secure form of long-term investment that pays a good return.

Secondly, for all the talk of bricks and mortar being solid and unchanging, the sector has proven to be remarkably flexible over the years.

The use of land and buildings can change over time, and often remarkably quickly. For evidence, you need only look at your own surroundings. Shops have turned into flats and old factories have been transformed into hotels.

The coronavirus pandemic may appear to be a massive shock to property markets, but it may well just speed up changes that are already taking place.

Enjoy the reading and we are looking forward to welcoming you at our Committee meetings!

Moscow market overview

Capital market, Q2 2020

• In H1 2020, the investment volume decreased by 20% YoY to USD 1.3 billion. The main drop was in Q2, with USD 491 million, 26% down from H1 2019 indicator.

• The residential sector (land plots for residential development) occupied the leading position in H1 2020, accounting for 56% of the total volume. Office and industrial sectors followed, with 24% and 10% respectively.

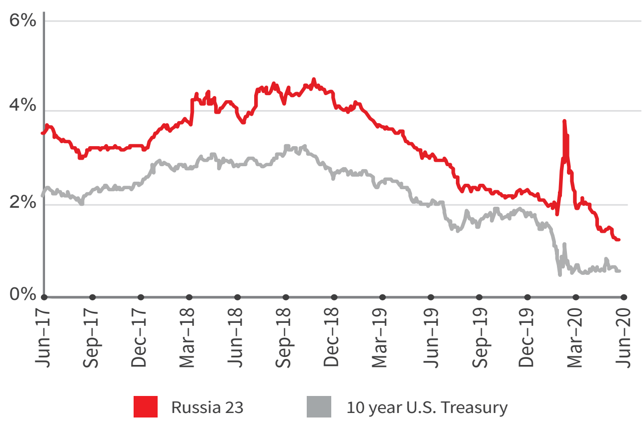
• The share of Moscow increased to almost 82% in H1 2020 compared to 72% in 2019. The share of St. Petersburg decreased to 17% of the country's volume in H1 2020 from 21% in H1 2019. The share of deals closed in other regions (outside Moscow and St. Petersburg) accounted for less than 1%.

• As benchmarks for the market we consider Moscow prime yields between 8.5-10.0% for offices and shopping centres and 11.0-12.0% for warehouses; St. Petersburg prime yields at 9.0-11.0% for offices and shopping centres and 11.0-12.5% for warehouses. (**1–9 ▶**)

1 ▶ RUSSIA REAL GDP GROWTH

Source: Rosstat, Oxford Economics

2 ▶ SOVEREIGN BOND YIELDS

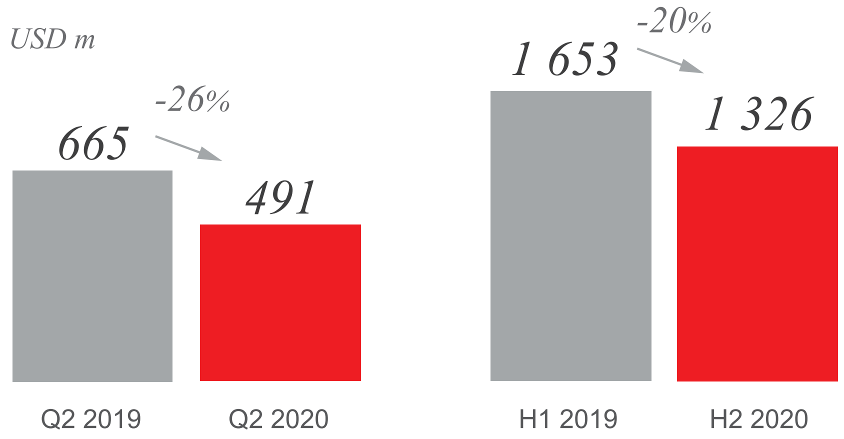


Source: Bloomberg

3 ▶ EXCHANGE RATE DYNAMICS, USD/RUB

Source: Central Bank of Russia

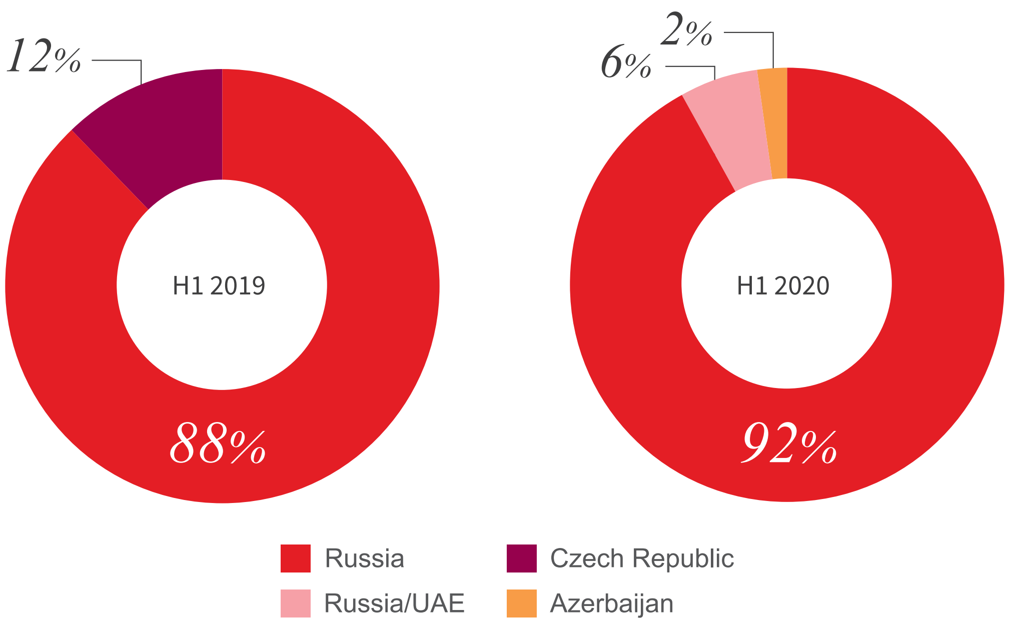
4 ▶ RUSSIA INVESTMENT VOLUME DYNAMICS*



*Investment deals excluding deals with land plots, joint ventures, sales of residential real estate to end-users.

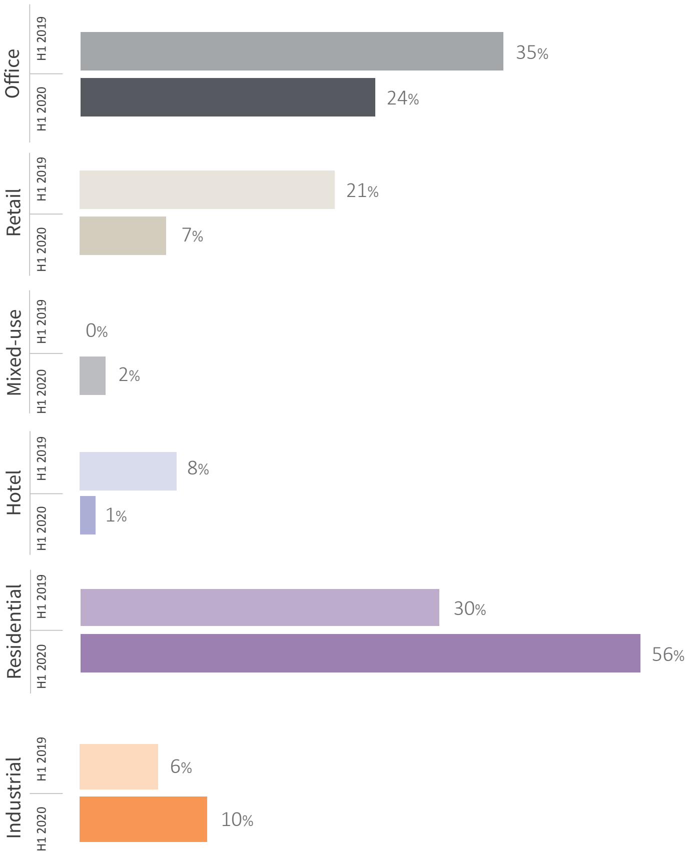
Source: JLL

5 ▶ INVESTORS BY SOURCE OF CAPITAL



Source: JLL

6 ▶ INVESTMENT VOLUME BREAKDOWN BY SECTOR



Source: JLL

7 ▶ PRIME YIELDS IN MOSCOW

Moscow

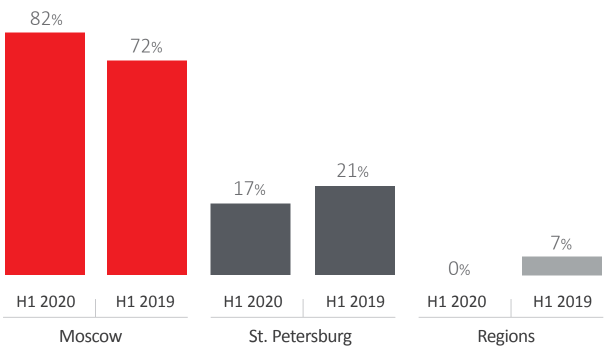
min		max
8.50%	Office	10.00%
8.50%	Shopping centre	10.00%
11.00%	Warehouse	12.00%

St. Petersburg

min		max
9.00%	Office	11.00%
9.00%	Shopping centre	11.00%
11.00%	Warehouse	12.50%

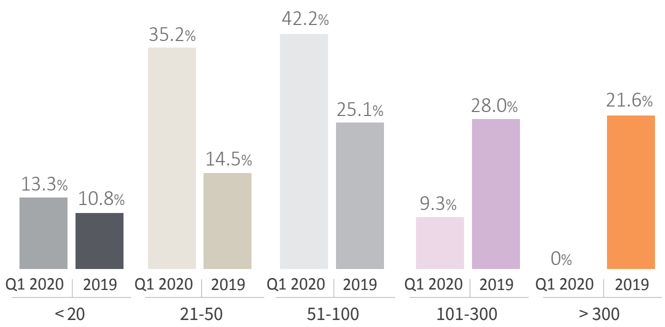
Source: JLL

8 ▶ INVESTMENT VOLUME BREAKDOWN BY REGION



Source: JLL

9 ▶ INVESTMENTS BY DEAL SIZE (VOLUME, USD M)

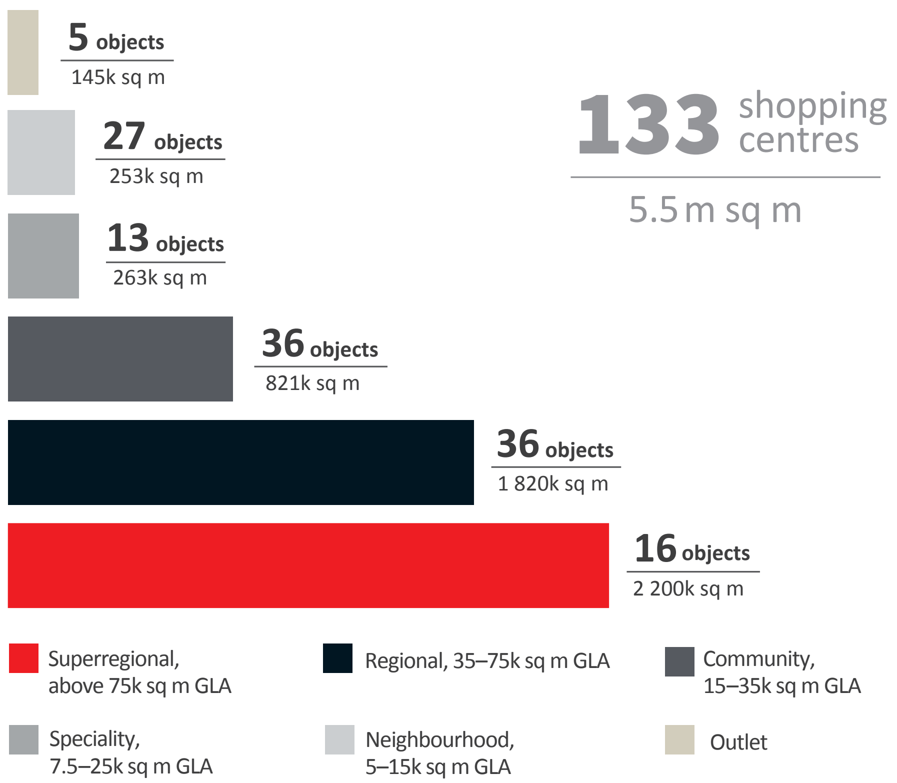


Source: JLL

Retail market, Q2 2020

• Shopping centre completions on the Moscow market amounted to 142,000 sq m* in H1 2020. In addition to the opened schemes some 187,000 sq m are expected to enter the Moscow market in H2 2020. If there are no postponements, the 2020 completions will two times exceed the new supply of 2019.
• The trend of a declining vacancy rate that has been seen in Moscow shopping centres since 2016 has reversed. Over the past six months of 2020 the vacancy rate increased by 1.1 ppt to 5.2%.
• The vacancy rate on the Moscow market might grow to 8-10% by the end of 2020.
• The inflow of new international retailers declined in H1 2020, with only 7 entering the Russian market, which is 4 brands less than in H1 2019. This is the lowest level for the history of observation. (10–18 ▶)

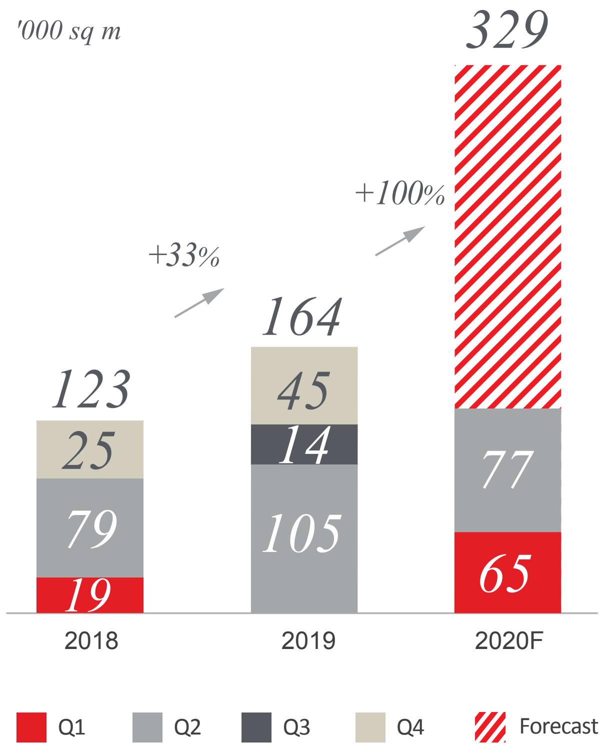
10 ▶ SHOPPING CENTRE SUPPLY



Source: JLL

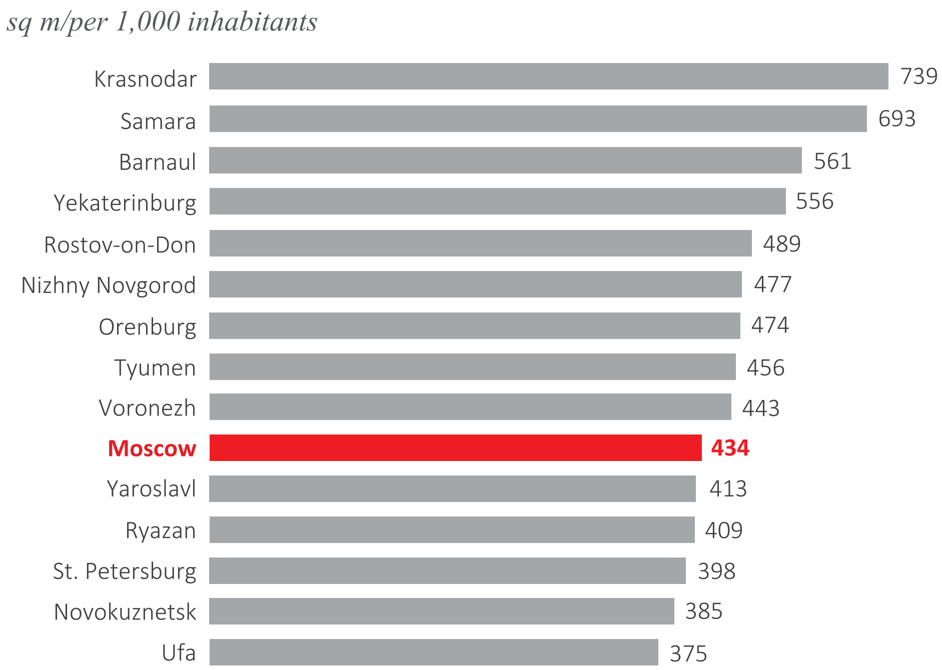
* Hereinafter we refer to gross leasable area (GLA).

11 ▶ SHOPPING CENTRE COMPLETIONS



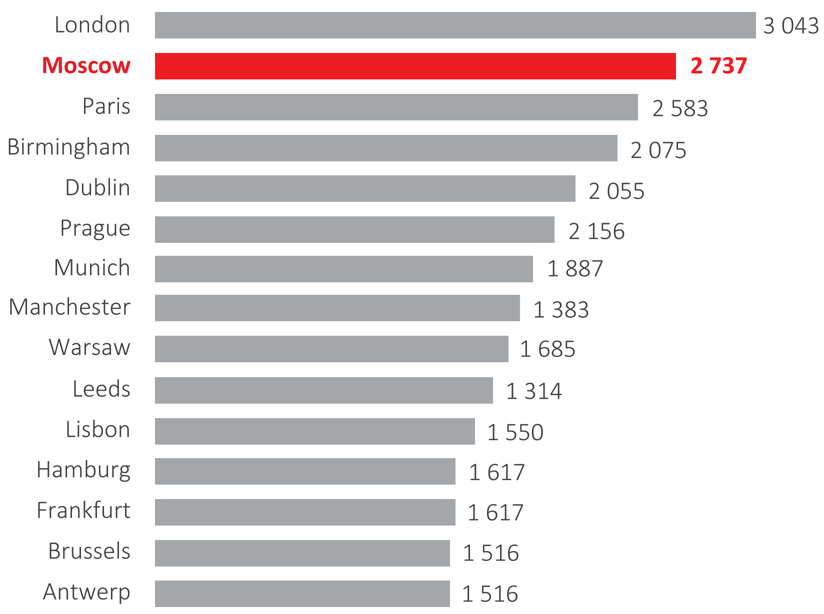
Source: JLL

12 ▶ SHOPPING CENTRE DENSITY IN RUSSIAN CITIES



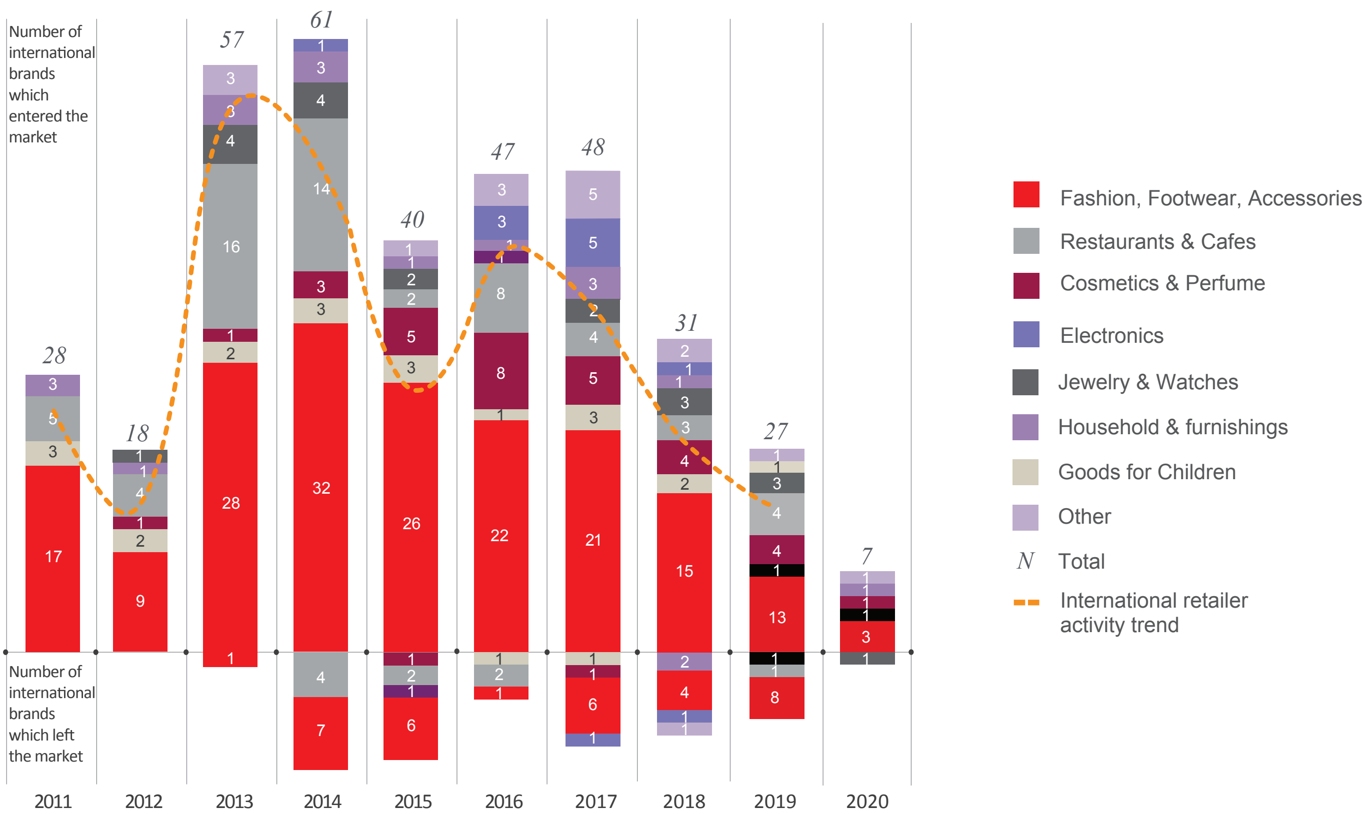
Source: JLL

13 ▶ PRIME RENT: EUROPEAN COMPARISON



Source: JLL

14 ▶ NEW RETAILERS ON THE RUSSIAN MARKET: ENTRIES AND EXITS



Source: JLL

15 ▶ AVAILABILITY

Overall SC vacancy rate

4.1% (Q4 2019) — 110 bps — **5.2%** (Q2 2020)

*Prime SC vacancy rate**

1.2% (Q4 2019) — 10 bps — **1.3%** (Q2 2020)

*Based on a selection of the most successful shopping centres with high footfall and conversion rates.

Source: JLL

16 ▶ PRICING**

Prime rent, RUB/sq m/year

195,000 (Q4 2019) — 0% — **195,000** (Q2 2020)

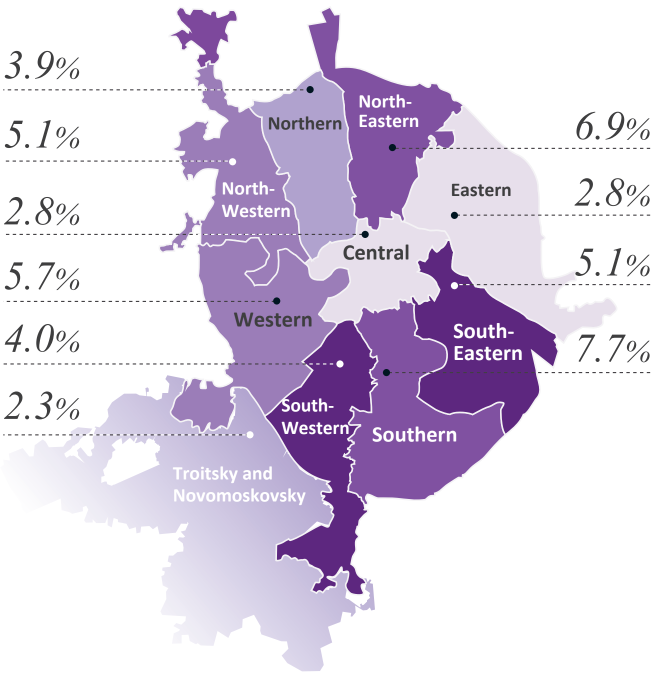
Average rent, RUB/sq m/year

74,000 (Q4 2019) — 0% — **74,000** (Q2 2020)

**Rents are given for a single unit of 100 sq m GLA located on a ground floor of a retail gallery. Rents exclude VAT and OPEX. Higher level rents that exceed the market level are registered occasionally.

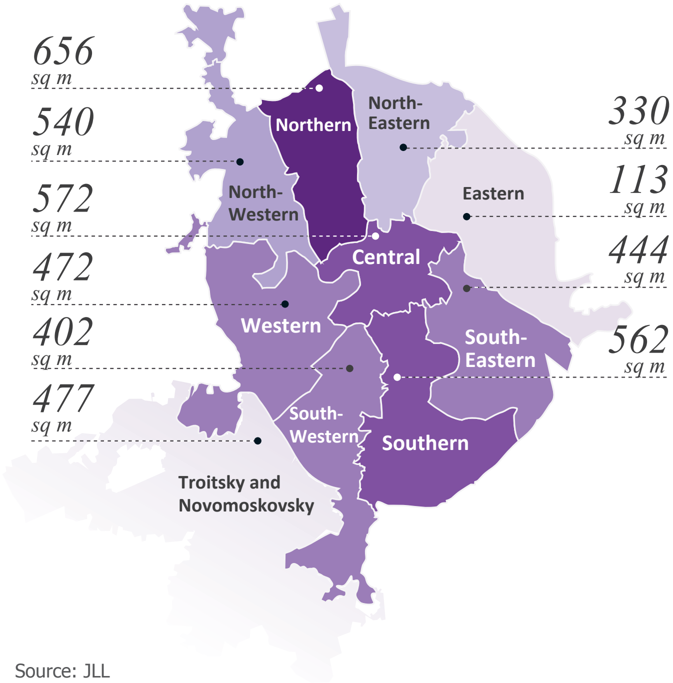
Source: JLL

17 ▶ VACANCY RATE IN MOSCOW DISTRICTS



Source: JLL

18 ▶ SHOPPING CENTRE DENSITY IN MOSCOW DISTRICTS (SQ M PER 1,000 INHABITANTS)



Source: JLL

Office market, Q2 2020

• In H1 2020, the new supply on the Moscow office market was 60,900 sq m (decreased by 2 times YoY). In Q2 2020, only two objects of class B+ with a total area of 5,000 sq m were introduced. The completion in 2020 will be reduced and will amount to about 352,000 sq m. The completions in 2020 will be reduced and will amount to about 352,000 sq m.

• The total volume of new office deals in H1 2020 in the Moscow office market decreased by 18% YoY and amounted to 473,000 sq m. At the same time, 30% of the total volume of new office deals is occupied by the deal of Tinkoff Bank in business-centre AFI Square, the largest lease transaction in the history of the market.

• Class A accounted for 44% of the total demand in H1 2020. More than half of all deals in H1 2020 were closed outside the Third Transport Ring (TTR).

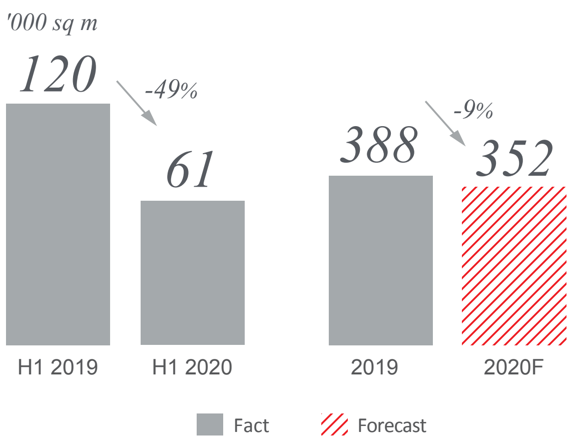
• The leading sectors in H1 2020 were banking & finance (37%), business services (19%) and service industries (16%).

• The increase in vacancy rate, which started in the beginning of the year, continued in Q2 2020. The growth of the vacancy rate is restrained by low new construction.

• The overall vacancy rate increased by 0.2 ppt to 10.7% in Q2 2020. The largest change was recorded in Class A: the vacancy rate increased by 2.3 ppt to 10.6%. At the same time, in Class B+ the vacancy rate decreased to the end of 2019 and amounted to 10%.

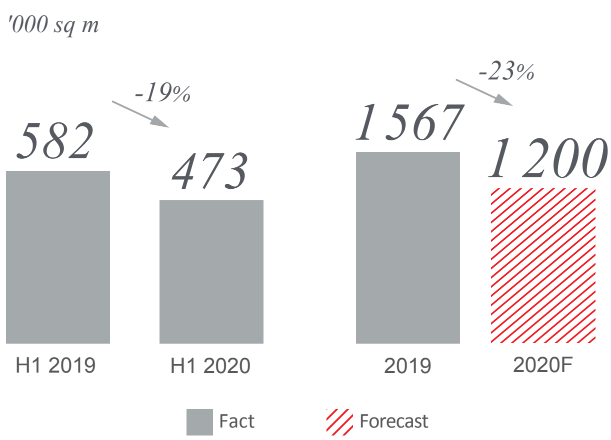
• Asking prime rental rates in Q2 2020 were at RUB 45,000-60,000sq m/year, Class A rental rates were at RUB 25,000-45,000/sq m/year, Class B+ rents were at RUB 12,000-25,000/sq m/year. (**19–26** ▶)

19 ▶ VOLUME OF NEW SUPPLY



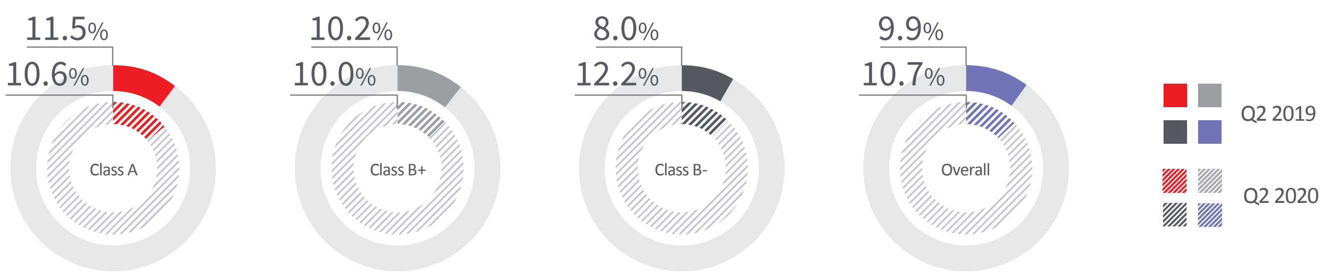
Source: JLL

20 ▶ VOLUME OF TRANSACTED SPACE



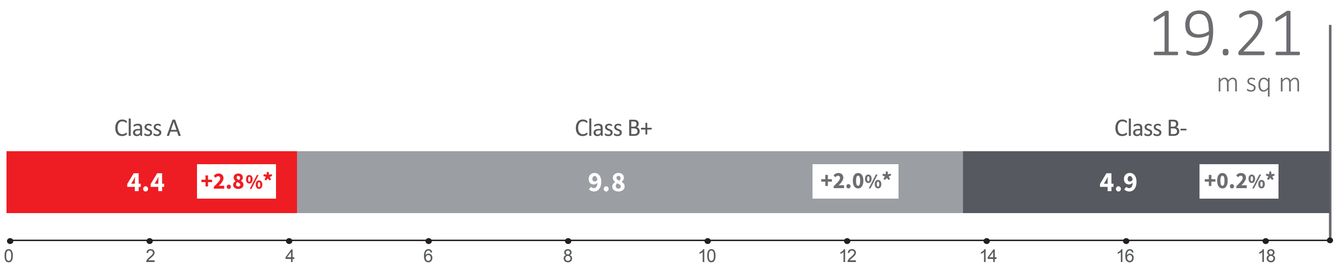
Source: JLL

21 ▶ VACANCY RATES BY CLASS



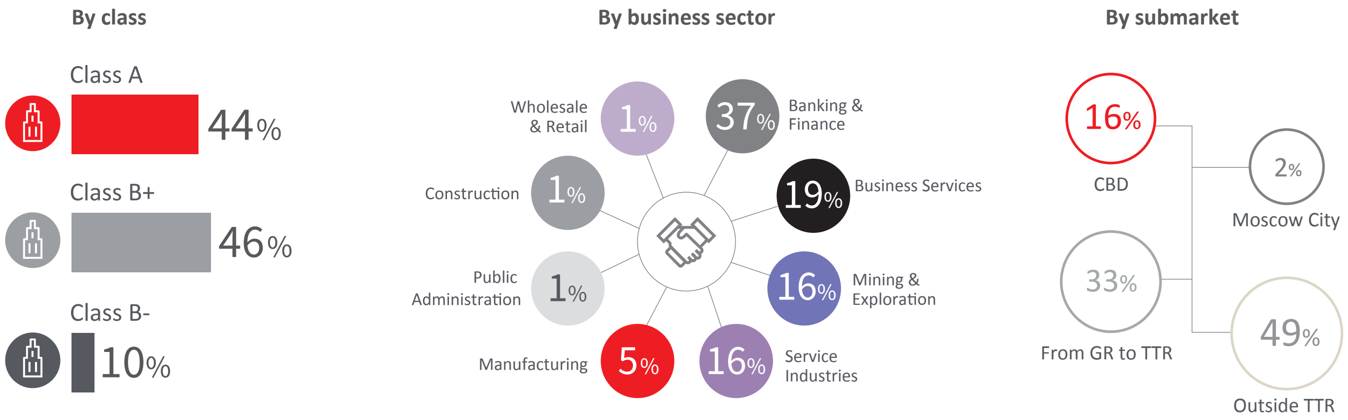
Source: JLL

22 ▶ MOSCOW OFFICE STOCK BY CLASS, Q2 2020



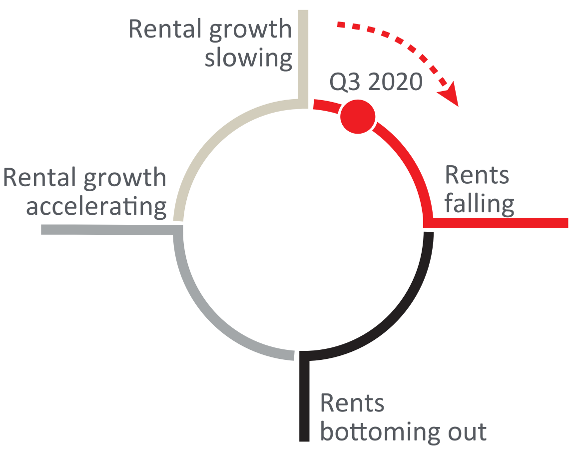
Source: JLL

23 ▶ TRANSACTED SPACE BY CLASS, SECTOR AND LOCATION, H1 2020



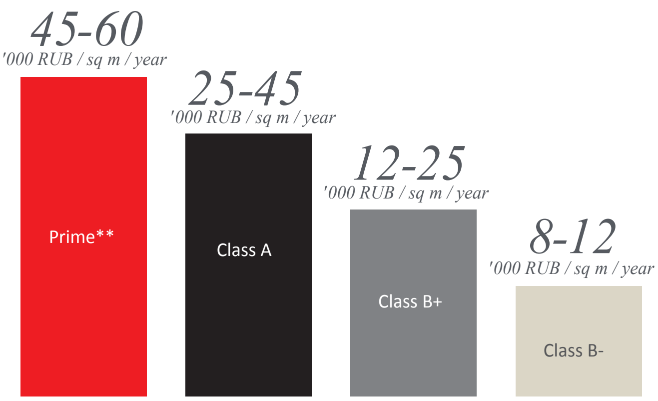
Source: JLL

24 ▶ OFFICE PROPERTY CYCLE IN MOSCOW



Source: JLL

25 ▶ ASKING RENTS*



*Asking rents (including pre-lets) exclude VAT.

**Prime rents refer to rents in high quality buildings in the Central Business District (CBD).

Source: JLL

26 ▶ MOSCOW OFFICE SUBMARKETS, H1 2020

	CBD*	Moscow City	From GR to TTR**	Outside TTR***
Stock, sq m	4,046,656	1,226,580	4,585,764	9,348,414
Availability, sq m	289,758	102,562	462,437	1,201,930
Vacancy rate, %	7,2	8,4	10,1	12,9
Transacted space, sq m	77,448	10,017	156,240	229,745

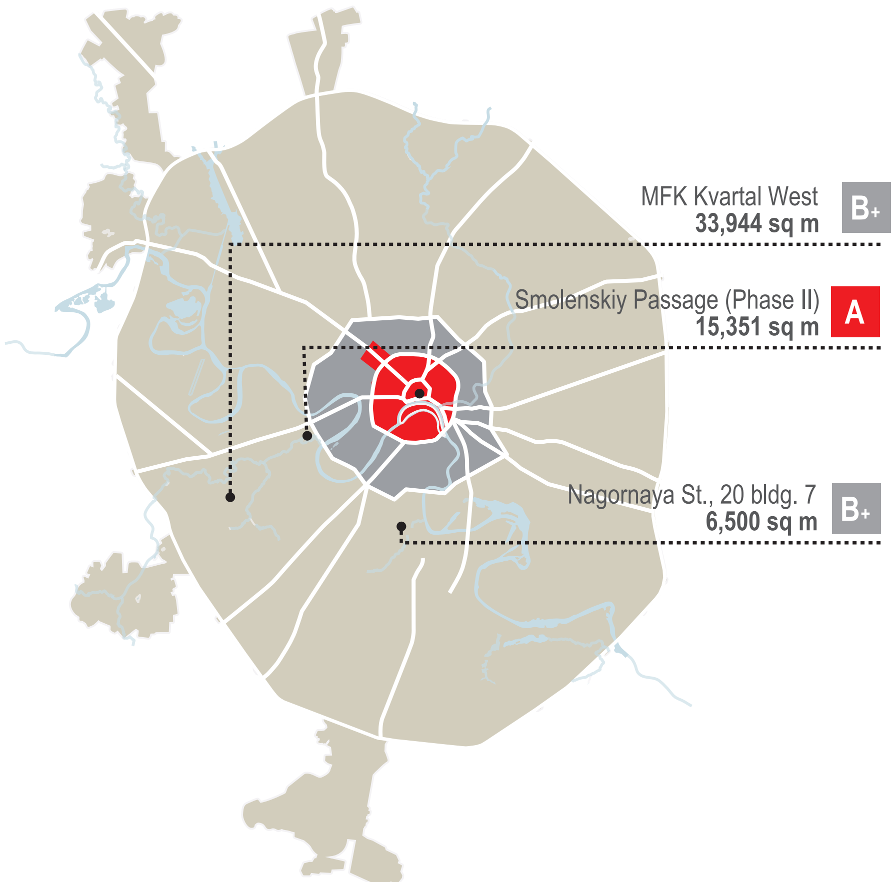
*The Central Business District (CBD) submarket comprises the area within and in close proximity to the Garden Ring (GR) and Tverskaya-Yamskaya Street.

** Excludes Moscow City.

*** Including outside MKAD projects.

Source: JLL

27 ▶ KEY NEW SUPPLY IN H1 2020



Source: JLL

Warehouse market

• As compared to other commercial real estate segments, warehouse segment was less affected by the shock brought by the pandemic.
• In H1 2020, slowdown of construction activity was registered.
• Lack of quality warehouse spaces and slowdown of construction activity in the Moscow region keep the rental rates and level of vacant spaces on the level of the end of 2019.

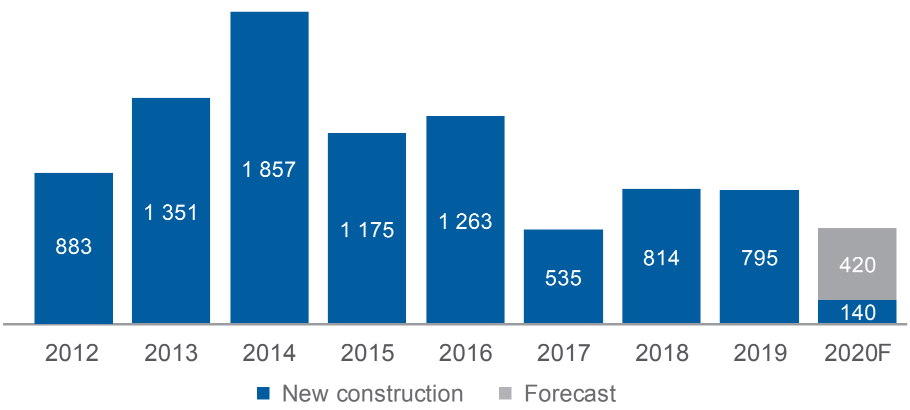
Lack of quality space, growing rental rates and decreasing vacancy determine a growth of warehouse segment in 2020. However, negative macroeconomic effects of H1 2020 cooled down the rapid market growth.

At the end of Q2 2020, the total volume of new warehouse spaces in the Moscow region reached 140,000 sq m. (**28** ▶)

Despite the fact that speculative construction is a more sensitive sector for any market changes, 48% of new projects will be built speculatively. (**29** ▶)

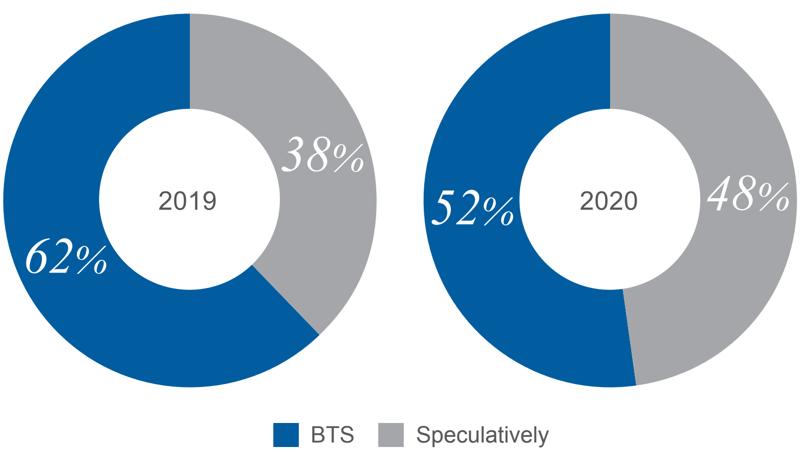
South direction is still the most demanded in the Moscow region. 20% of the new warehouse space will be built in this direction. In 2021, construction of two large projects with total area of more than 1 million sq m will start in the south of the Moscow region – PNK Park M-4 and Rusich industrial park.

28 ▶ NEW CONSTRUCTION, CLASSES A&B, '000 SQ M



Source: Cushman & Wakefield

29 ▶ NEW CONSTRUCTION, CLASSES A&B, TYPE OF PROJECT (2019 VS 2020)



Source: Cushman & Wakefield

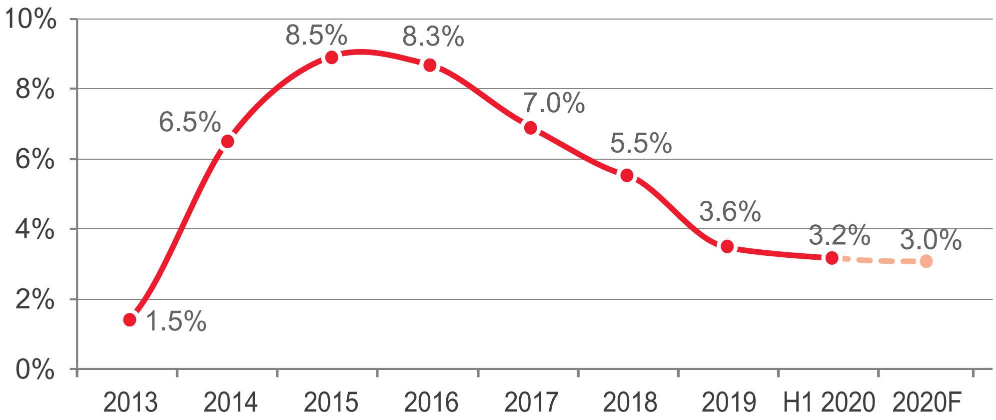
SLOWDOWN OF BUSINESS ACTIVITY IN THE PANDEMIC DECELERATED A DECREASE OF VACANCY RATE

In H1 2020 the vacancy rate reached 3.2%. The largest share of vacant space in the H1 2020 was recorded in the west of the Moscow region – 5% of the total stock in this area.

The lowest share of vacant spaces was recorded in the north-west of the Moscow region – less than 1% of the total stock in this direction.

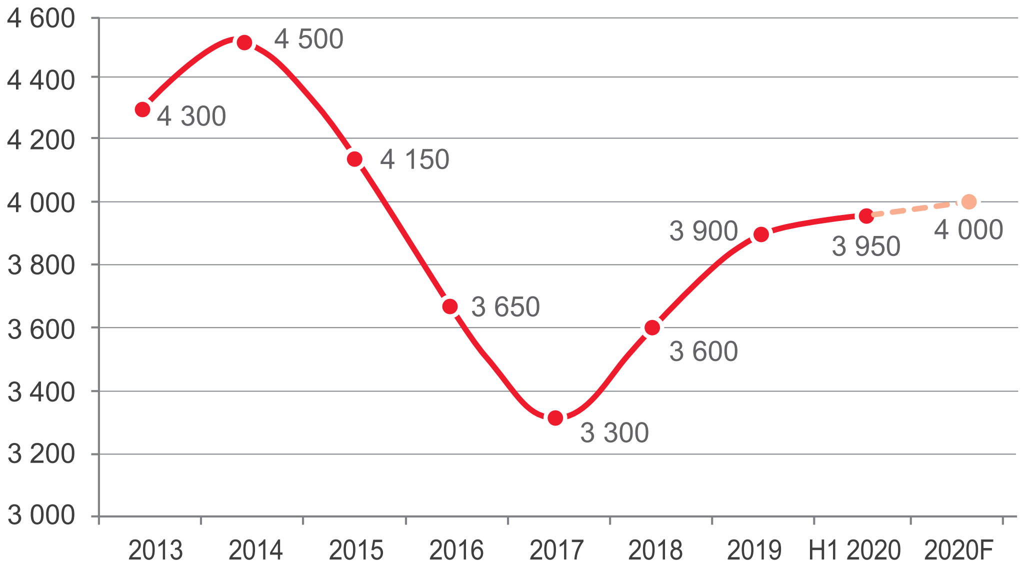
One of the most significant factors having an affect on supply and demand balance is that new construction remains on a low level. Due to this the vacancy rate is expected to reach the level 3.0 p.p. by the end of 2020. (**30**)

30 VACANCY RATE, CLASS A



Source: Cushman & Wakefield

31 RENTAL RATE, CLASS A, RUB/SQ M/YEAR



Source: Cushman & Wakefield

The average rental rate for class A is 3,950 RUB per sq m per year. As a result of new construction slowdown, we expect a moderate growth of the average rental rate for class A by the end of the year. It will reach 4,000 RUB per sq m per annum. (31 ▶)

In the south (the most demanded direction) the average rental rate is 4,200 RUB per sq m per year. The lowest level of the rental rate for class A is in the south-east: 3,700 RUB per sq m per year.

INCREASED DEMAND FROM FOOD AND ONLINE RETAILERS SUPPORTED THE WAREHOUSE SEGMENT

In January – June 2020, take-up in the Moscow region reached 521,000 sq m, which is 1.7 times less than in the first half of 2019. It is one of the lowest levels over the last 5 years. We expect take-up to reach 900,000 sq m by the end of 2020. It will be the lowest figure since 2011. (32 ▶)

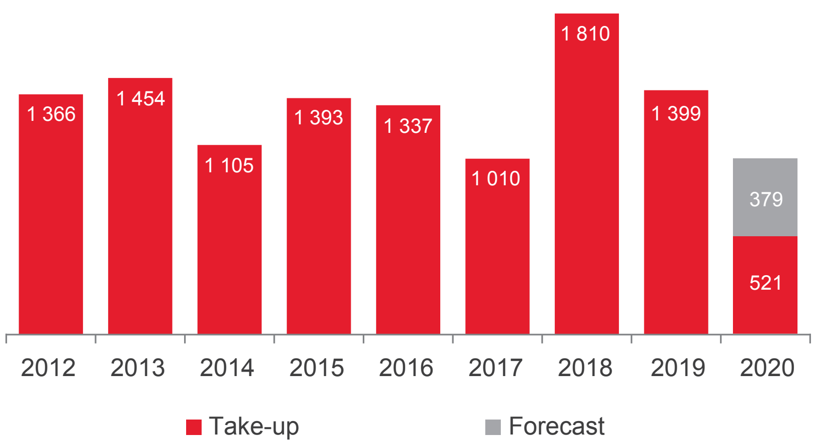
Take-up in Q2 2020 was 2.4 times higher than in Q1 2020 and reached 368,239 sq m. Take-up was driven by increased demand from online and food retailers as well as transport companies during the lockdown. Businesses efficiently adapted to new market conditions.

In H1 2020 e-commerce companies occupied the biggest share (32%) in the structure of buy and lease transactions. During the lockdown several companies signed short-term agreements for additional spaces.

For instance, the online retailer Wildberries signed two short-term agreements for additional space in Klimovsk and Krekshino logistics parks – 35,000 sq m in total.

In Q3-4 2020, we expect demand recovery from other business sectors, additionally to food and online retailers. In the middle of Q2 2020 we noted growth of demand from logistics companies and producers. However, in 2020 food and online retailers are the main drivers of warehouse market growth.

32 ▶ TAKE-UP, CLASSES A&B, '000 SQ M



Source: Cushman & Wakefield

WAREHOUSE SEGMENT AFTER COVID-19

The post-coronavirus period was marked by a revision of some forms of commercial real estate businesses.

Self-isolation and high-demand for online purchases made it obvious that the online retail segment has issues with the scaling of business and turnaround time for orders. Soon it will have an impact on urban logistics development.

Last mile warehouse is the most expensive stage of the e-commerce logistics that refers to the end of supply chain when the parcel is delivered to the customer. A general rule for the segment is to be located within a 30-minute drive time to client. For this reason, this facility should be constructed within the city borders.

In the future, we see the opportunity of re-development of some retail spaces for urban logistics, especially those shopping centres that are located far away from major streams of people. However, nowadays there are no ready solutions for such re-development. Additionally some shopping centres cannot offer premises for urban logistics due to specific technical parameters.

Intensive growth of e-commerce requires large investments in the development of digital infrastructure. Since, most likely, the data centre market of Russia expects a certain booming (the law on the storage and processing of personal data of Russians using servers located on the territory of Russia limits the opportunities for companies operating in the territory of Russia to use global resources), then given the market prospects, nowadays there are more and more large-scale projects for the development of data centres.

The main factor that determines the demand for a particular product and determines its success will be cost of services (undoubtedly, together with their quality). Therefore, in the next few years, the companies that will be able to optimize the cost of the services will determine the price and win the competition.

Nowadays, a number of large world companies are discussing the merger of their research centres to improve technical equipment for data centres. And here it is obvious that large companies are more flexible in cost management and have the advantages over the other market players. Data centre chain as a business model is more sustainable and profitable than one standalone project.

Hospitality market

The upscale segment demonstrated a positive trend in rouble average daily rate (ADR) compared to Q2 2019 and showed 8% increase (RUB 14,501). Rouble revenue per available room (RevPAR) showed a decrease – 62% and comprised RUB 3,590. US dollar figures of ADR remained unchanged and comprised 206 US dollars, however US dollar RevPar dropped by 63% (USD 53). The overall occupancy decreased by 43% in Q2 2020 (28%).

Business hotels showed the following results in January – June 2020: US dollar RevPAR decreased by 61% (USD 27) which was composed of an 42% occupancy decrease (35%) and 28% drop of ADR nominated in US dollars (USD 64). The rouble RevPAR decreased by 59% (RUB 1,832) and ADR dropped by 22% (RUB 4,466).

A drop of indicators was observed in the midscale segment. ADR and RevPAR nominated in roubles decreased by 18% and 50% respectively amounting to RUB 3,003 and RUB 1,368. The US dollar ADR dropped by 24% (USD 43) so as RevPAR which decreased by 53% (USD 20). Overall occupancy fell by 32% (43%).

Economy segment of Moscow hotels which is mostly represented by Soviet-era objects showed ADR in the amount of RUB 1,699 in Q2 2020 (21% increase as compared with 2019). Occupancy demonstrated 47% drop (23%) resulting in 64% decrease of RevPAR – RUB 536. ADR in US dollar equivalent decreased by 27% and comprised USD 24. RevPAR amounted to USD 8 which is 65% lower comparing to the corresponding period of 2019.

Average occupancy across all market segments of Moscow hotels showed a decrease – 41% and comprised 32%. During Q2 2020 US dollar ADR decreased by 12% (USD 84). ADR nominated in roubles decreased by 5%, and amounted to RUB 5,917. US dollar RevPAR and RevPAR nominated in roubles decreased by 61% and 59% respectively amounting to USD 27 and RUB 1,831.

Comparing the results of Q2 2020 to the same period of the previous year we can observe a significant decrease of both rouble and US dollars figures, that was caused by the following facts:

• overall influence of COVID-19 and respective restrictive measures taken in Russia and in other major countries to prevent its advance resulted in a sharp fall of tourist flows, which significantly affected the hotels' occupancy. According to preliminary forecasts, the situation may change for the better, starting from Q3 2020;

• the USD/RUB exchange rate raised by 13% in January – June 2020 comparing with the corresponding period of 2019. This fact explains a notable drop of indicators nominated in US dollars in line with a slight decrease of roubles figures.

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

• the gap between the upscale and midscale segments comprised USD 33/RUB 2,222 compared to USD 102/RUB 6,609 in the same period of 2019;

• the difference in RevPAR between upscale and business hotels changed to USD 26/RUB 1,758 vs Q2 2019 results (USD 75/RUB 4,911).

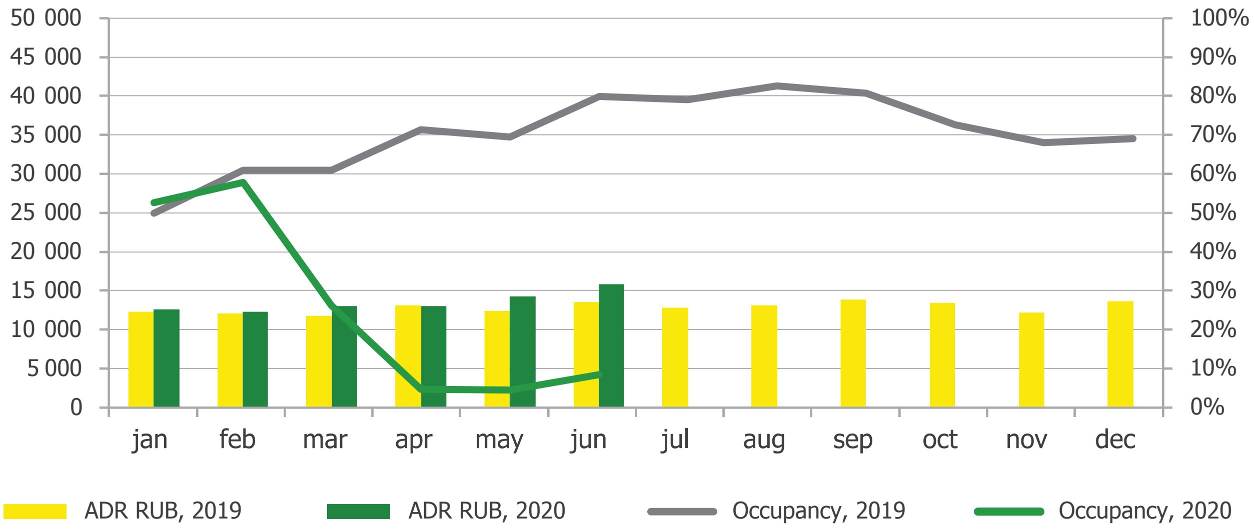
No new hotels opened during Q2 2020. The following branded hotels were announced for opening in 2020 but taking into account the current situation with COVID-19 development we expect that these openings may be postponed till the next year. (**25-31** ▶)

33 ▶ FUTURE BRANDED HOTELS ANNOUNCED FOR OPENING IN MOSCOW IN 2020

Name	Number of rooms	Address
Crowne Plaza Moscow – Park Huaming	340	Vilgelma Pika Street, 14
Four Points by Sheraton Moscow Vnukovo Airport	250	Vnukovskaya Bolshaya Street, 8
Hampton by Hilton Rogozhsky Val	147	Rogozhsky Val Street, 12
Marriott Imperial Hotel	268	Krasnoprudnaya Street, 12, bldg. 1
Mövenpick Moscow Taganskaya	156	Zemlyanoy Val Street, 70, bld. 1
Vertical BW Signature Collection	83	Malye Kamenschiki Street, 16
Total: 6 hotels	**1244 rooms**	

Sources: EY database, open sources, operators' data

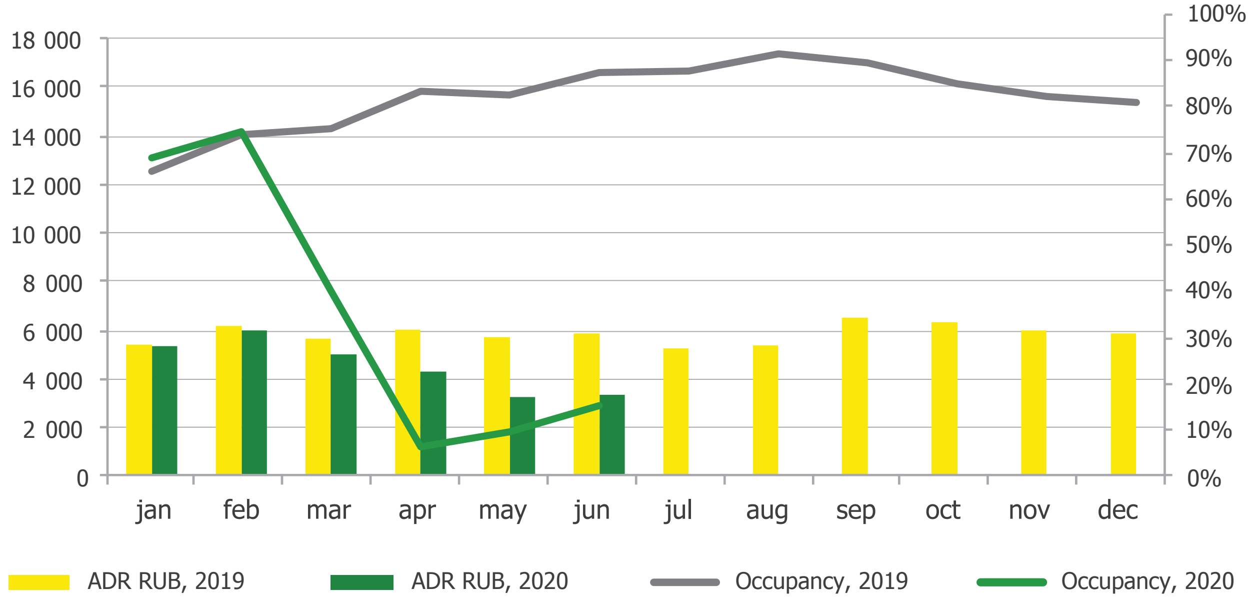
34 ▶ 5-STAR HOTELS: ADR* (RUB) AND OCCUPANCY DYNAMICS, 2020 VS 2019



* Average daily rate

Source: EY analysis

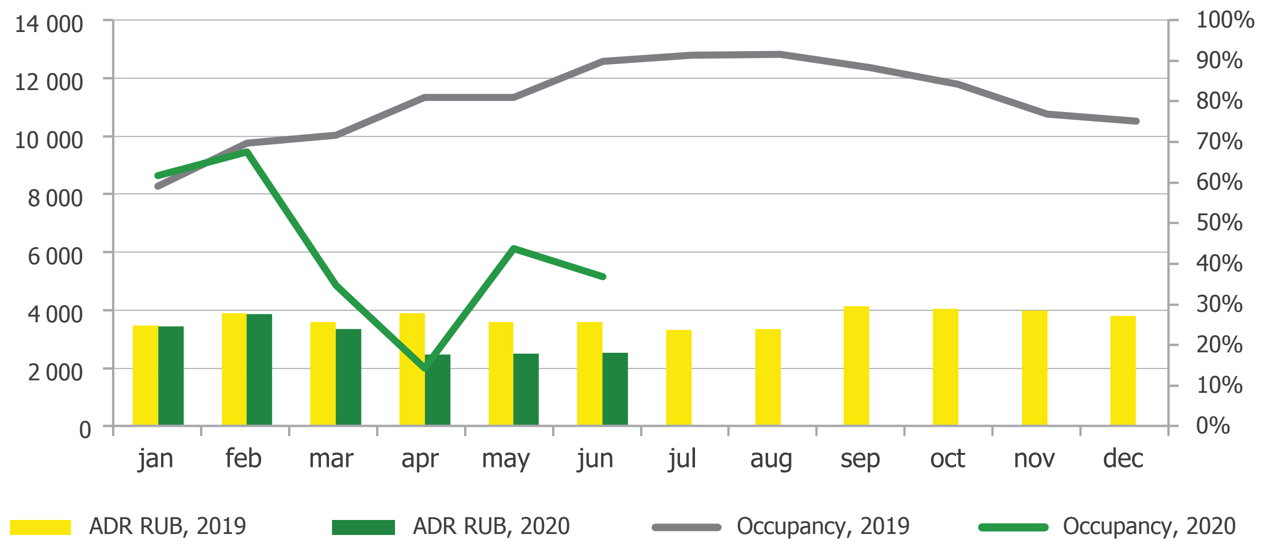
35 ▶ 4-STAR HOTELS: ADR* (RUB) AND OCCUPANCY DYNAMICS, 2020 VS 2019



* Average daily rate

Source: EY analysis

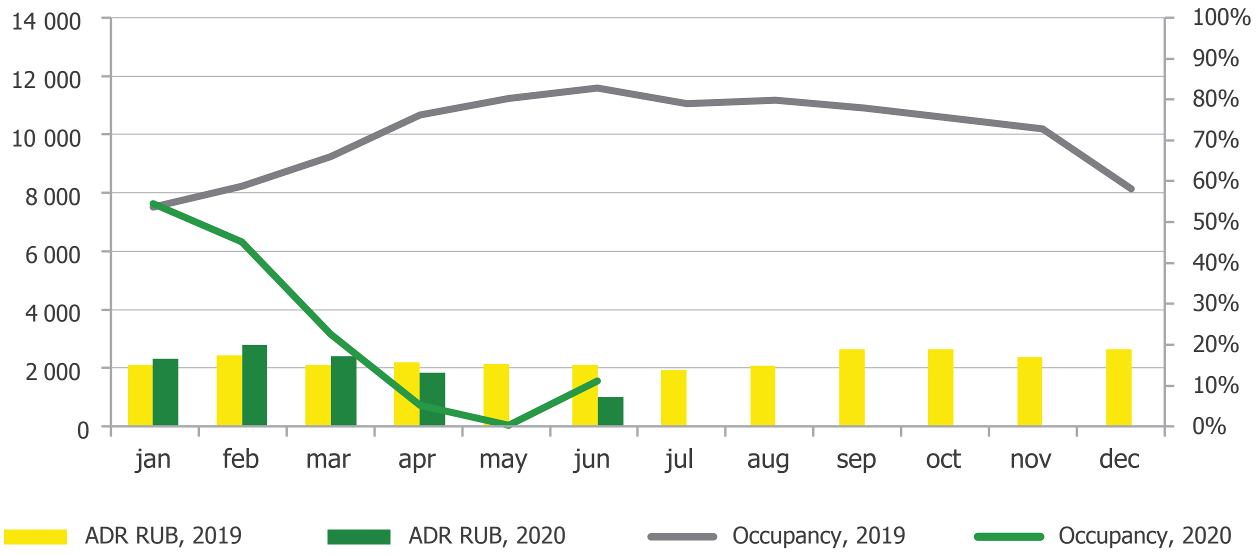
36 ▶ 3-STAR HOTELS: ADR* (RUB) AND OCCUPANCY DYNAMICS, 2020 VS 2019



* Average daily rate

Source: EY analysis

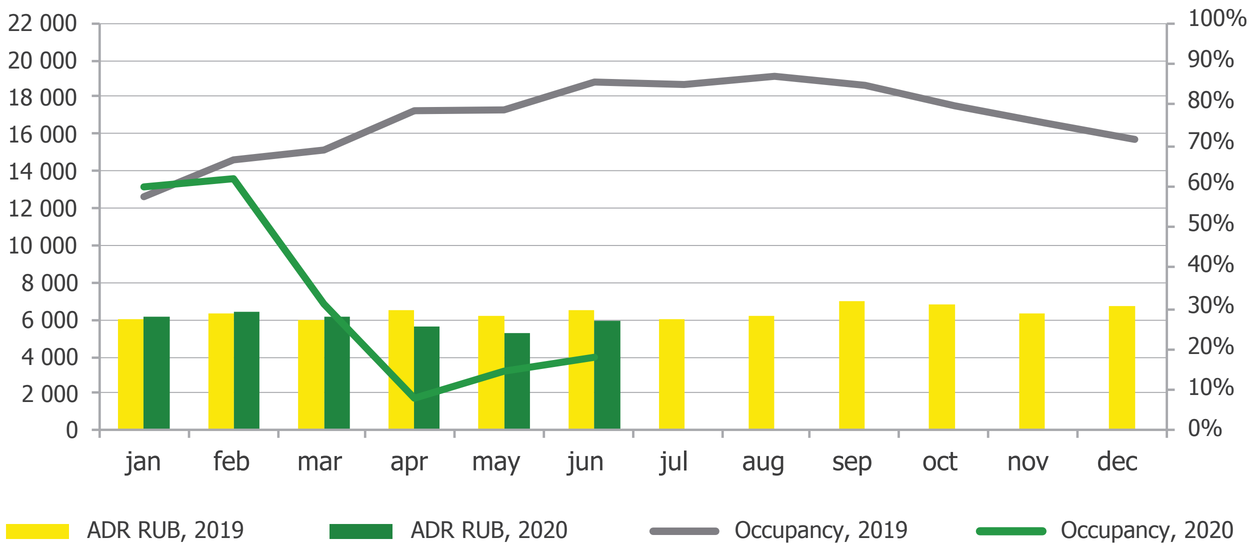
37 ▶ 2-STAR HOTELS: ADR* (RUB) AND OCCUPANCY DYNAMICS, 2020 VS 2019



* Average daily rate

Source: EY analysis

38 ▶ AVERAGE MARKET ADR* (RUB) AND OCCUPANCY DYNAMICS, 2020 VS 2019



* Average daily rate

Source: EY analysis

39 ▶ OPERATIONAL INDICES DYNAMICS

	January – June 2020 (USD/RUB)	January – June 2019 (USD/RUB)	January – June 2020/ January – June 2019, %	2019 (USD/RUB)
5 stars				
Occupancy	28%	71%	-48%	76%
Average daily rate (ADR)	206/14,501	207/13,458	0/-8	214/13,808
Revenue per available room (RevPAR)	53/3,590	144/9,370	-63/-62	161/10,352
4 stars				
Occupancy	35%	78%	-42%	82%
ADR	64/4,466	88/5,732	-28/-22	89/5,774
RevPAR	27/1,832	69/4,459	-61/-59	73/4,720
3 stars				
Occupancy	43%	75%	-32%	80%
ADR	43/3,003	56/3,658	-24/-18	57/3,703
RevPAR	20/1,368	43/2,760	-53/-50	46/2,960
2 stars				
Occupancy	23%	70%	-47%	72%
ADR	24/1,699	33/2,154	-27/-21	35/2,257
RevPAR	8/536	23/1,495	-65/-64	25/1,613
Average				
Occupancy	32%	73%	-41%	77%
ADR	84/5,917	96/6,250	-12/-5	99/6,385
RevPAR	27/1,831	70/4,521	-61/-59	76/4,911

Source: Smith Travel Research, EY analysis and forecast

Housing market

• The demand from corporate clients for prime real estate has not yet matched the values achieved last year. Nevertheless, the market has started to revive.

• After the borders open between Russia and other countries, we expect to see an influx of expats and an increase in demand in the prime real estate market.

DEMAND

Since the start of the year, requests from potential corporate tenants decreased by 36% compared to the same period last year. (**40** ▶)

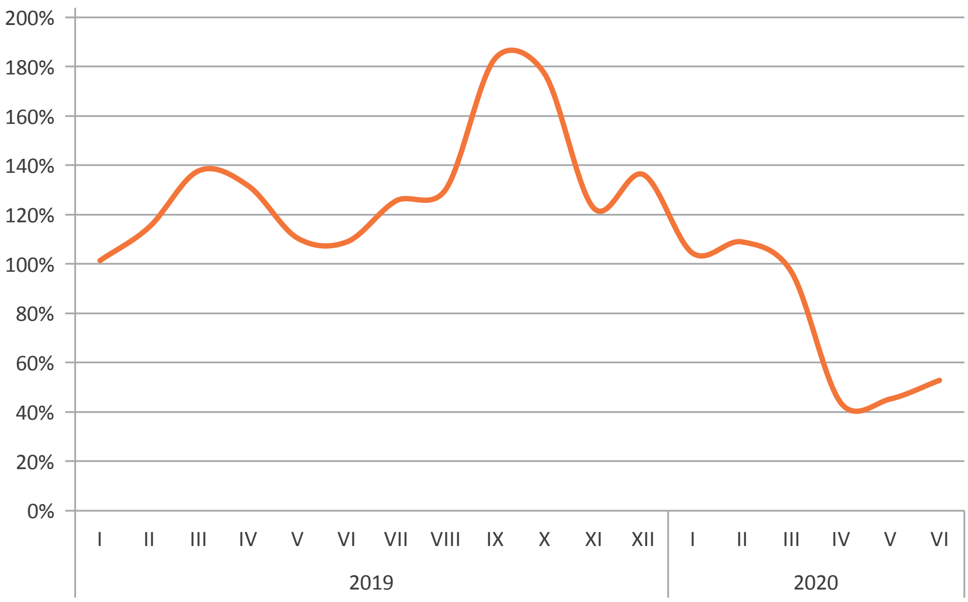
The largest drop in demand was noted in April 2020, as potential tenant activity decreased by 2/3 compared to the previous year.

Despite these numbers, the market began to revive. In June, there were 17% more requests from corporate clients for prime apartment rentals than in the previous month. In connection with the lifting of restrictions in Moscow related to the COVID-19 pandemic, the upward trend in demand should continue in the coming months.

Since the beginning of this year, the number of requests from private clients has not decreased, unlike the demand from corporate tenants. On the contrary, the number of requests from private tenants is growing. There has been an increase in the number of requests in comparison with the previous year. The activity of private Russian tenants in the rental market is currently extremely high.

We expect an increase in the level of demand from corporate clients immediately following the restoration of air traffic between Russia and other countries, as foreigners will have the opportunity to return to Russia to work.

40 ▶ DEMAND: CHANGING DYNAMICS (JANUARY 2019 – 100%)



Source: Intermark Relocation

SUPPLY

We are currently noting high competition in the prime rental market in Moscow. The number of vacant apartments has reached its highest levels since 2009.

In June 2020, the number of offers for rent increased by 26% compared to the same period last year and by 38% compared to the beginning of last year. (41 ▶)

As of one year ago, around 2/3 of all supply was concentrated within five districts: Arbat-Kropotkinskaya and Tverskaya-Kremlin (18% and 17% respectively), Leninsky Prospekt, Krasnopresnenskaya and Leningradsky Prospekt (approximately 9-10% each). (42 ▶)

RENTAL RATES

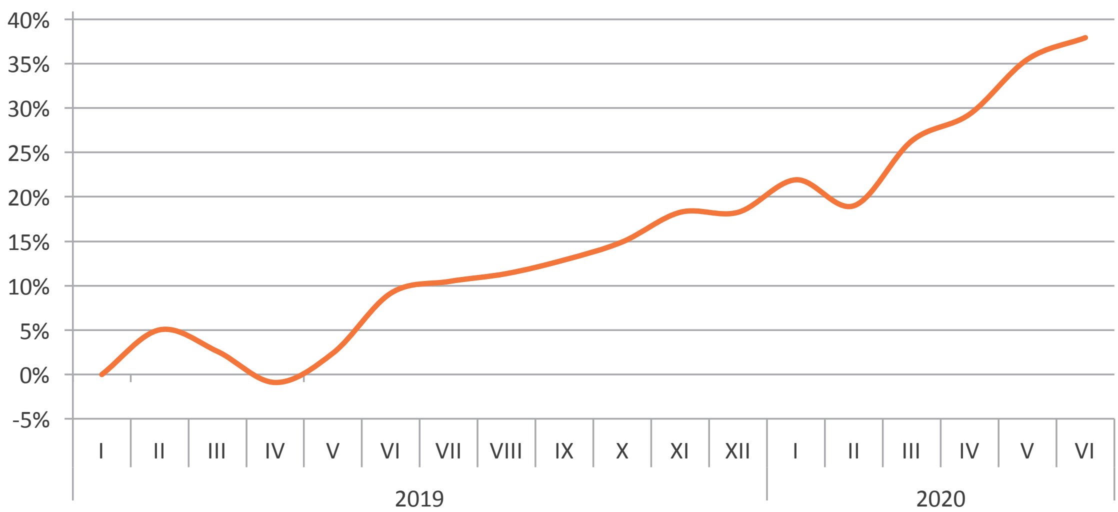
Rental rates for prime apartments did not change significantly between March and June 2020.

The average weighted supply budget for June 2020 remained at the April level of RUB 308,000 per property per month (compared to RUB 314,000 per property per month in April). As such, the value of this indicator in roubles decreased by 5%, since the beginning of the year and by 8% over the last year. (43 ▶)

The average weighted demand budget was RUB 263,000 per property per month. At the same time, there is still interest in renting ultra-premium apartments. For example, in May there was a request for renting an apartment with a budget of USD 14,000 per object per month.

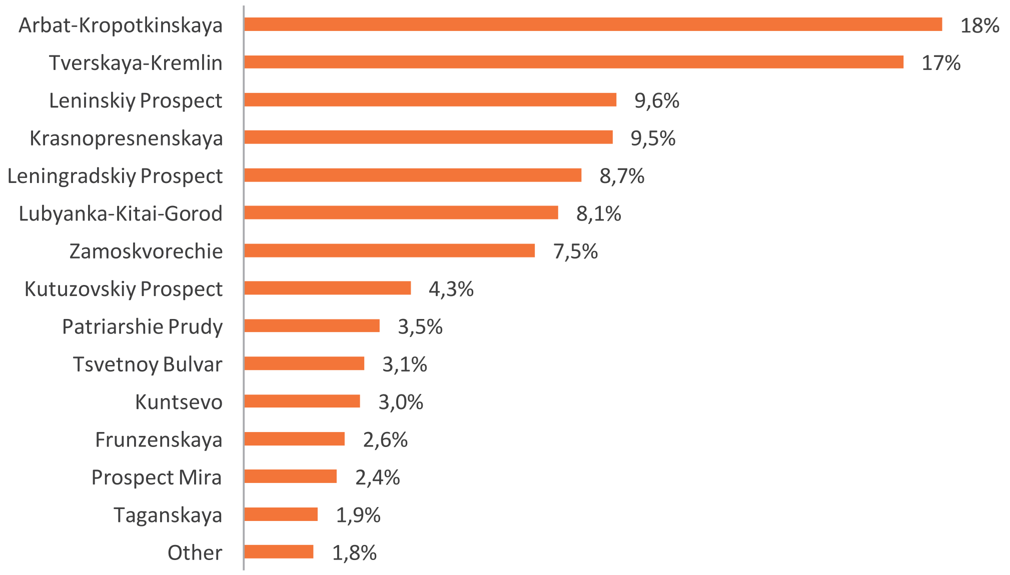
There is a tendency towards a more "balanced" market, when there is a minimal gap between expected rental rates from tenants and actual rates from landlords (17%).

41 ▶ SUPPLY: CHANGING DYNAMICS (JANUARY 2019 – 100%)



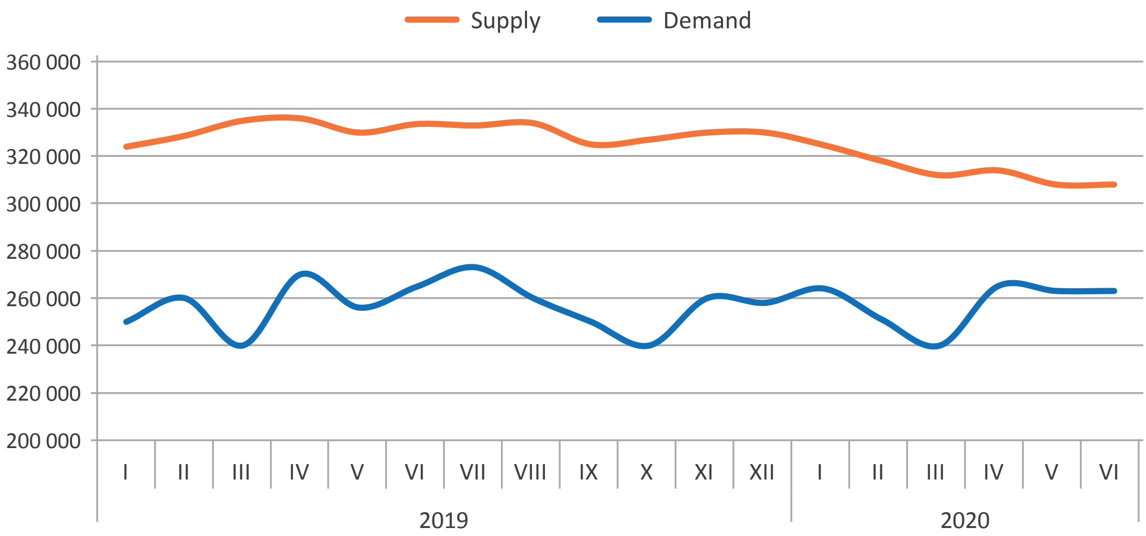
Source: Intermark Relocation

42 ▶ STRUCTURE OF SUPPLY IN TERMS OF AREA



Source: Intermark Relocation

43 ▶ SUPPLY/DEMAND CORRELATION, RUB



Source: Intermark Relocation

St. Petersburg market overview

Office market

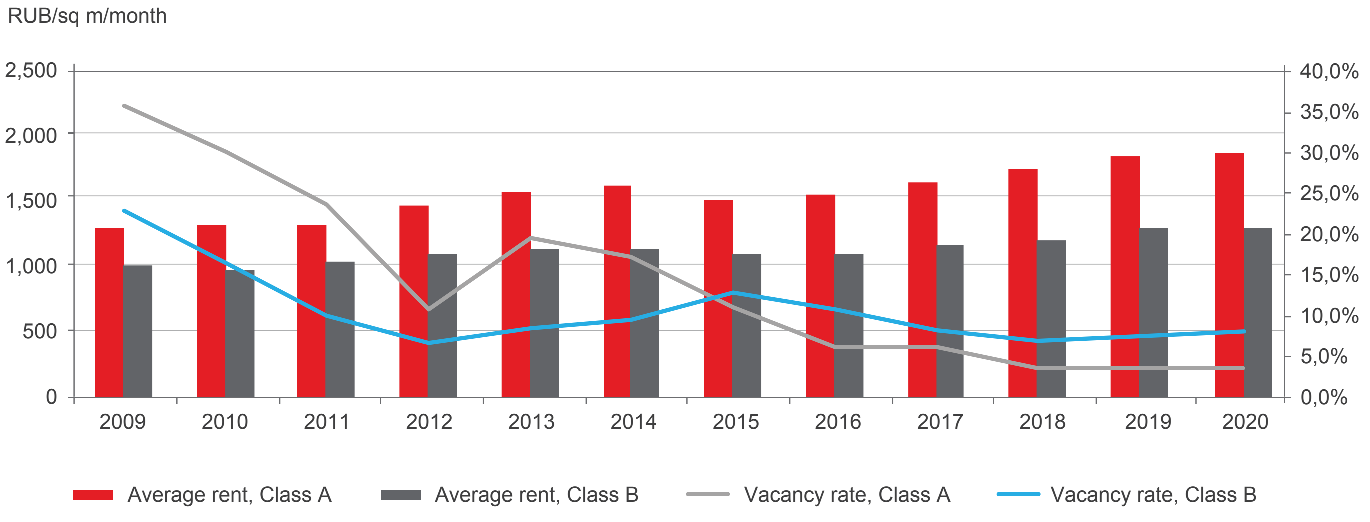
In Q2 2020, the vacancy rate increased by 1.2 ppt and reached 7.6%. The first signs of an upcoming recession became noticeable. The tenants' activity slowed down and almost stopped, while the number of requests to the landlords for rent free period, installment payments and lower rates increased.

The completions for Q2 2020 amounted to 18,000 sq m in 2 business centres. More than 200,000 sq m are scheduled for H2 2020, including 2nd phase of Lakhta Center with leasable area of 75,000 sq m.

However, in Q2 asking rental rates did not change. We expect declining of rental rates due to increased competition and low demand. The average asking rents in Class A are at RUB 1,907/sq m/month, Class B rents are at RUB 1,320/sq m/month (including VAT and operating expenses). (**44 ▶**)

Oil & gas and IT companies showed the highest demand on the St. Petersburg office market in recent years.

44 ▶ RENTAL RATES AND VACANCY RATE IN THE ST. PETERSBURG OFFICE MARKET



Source: JLL

Street retail market

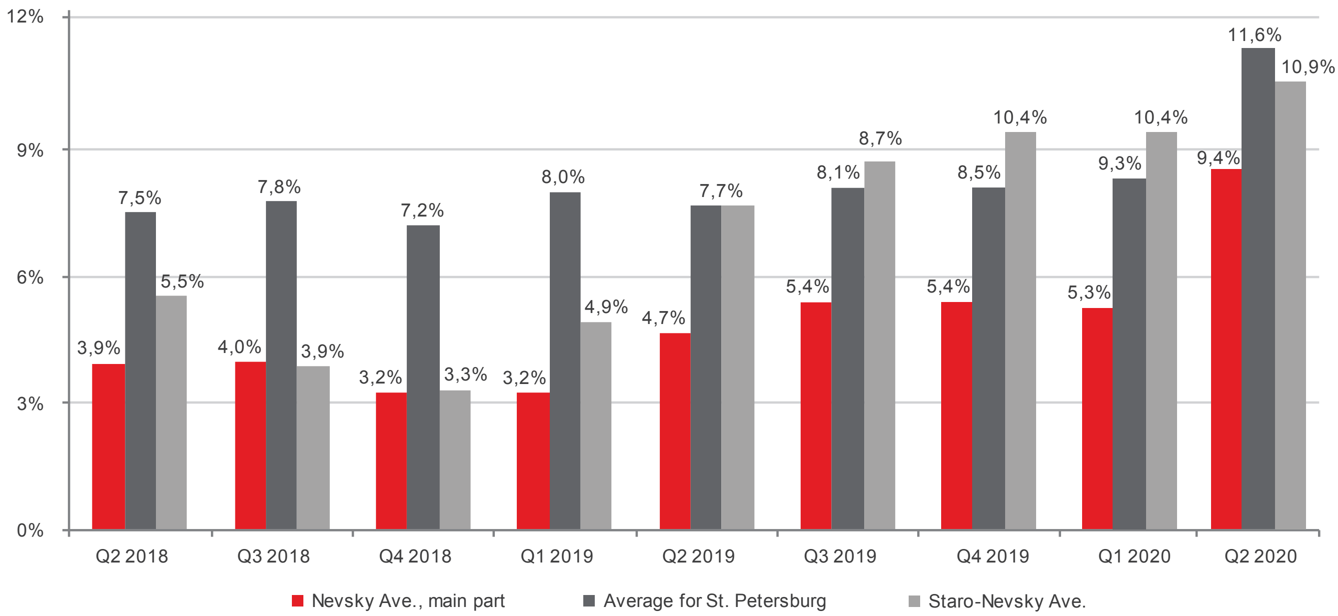
St. Petersburg street retail market was among the first sectors to encounter difficulties. The vacancy rate in Q2 increased by 2.3 ppt and amounted to 11.6%. This is the highest level observed in the last 5 years. We expect a further growth of the vacancy rate. (45 ▶)

The largest increase of vacancy rate was observed on Vladimirskiy Avenue. Vacancy increased three times and reached 15.7%. On Nevskiy Avenue many of souvenir shops were closed as a result of a decrease in the number of tourists.

On the other hand, new brands entered the market. Many attractive premises with good location provide a wide choice for new brands entered the market and an opportunity to expand the chain of existing ones. Breitling announced the opening of a shop at 129 Nevskiy Avenue, Suitsupply at 61 Bolshoy Avenue of Petrograd Side and Bork at 13 Bolshaya Konyushennaya Street.

It is noted a decline of the minimum border of base rental rates on the main part of Nevskiy Avenue from 8,000 roubles per sq m per month (including VAT) in March to 7,500 roubles per sq m in June. The maximum rates in this location are stable at 13,000 roubles per sq m. We expect a further growth of the vacancy rate and decreasing of rental rates.

45 ▶ VACANCY RATE DYNAMICS ON NEVSKY AVE. COMPARED TO THE AVERAGE



Source: JLL

Warehouse market

Only one warehouse complex with leaseable area of 5,000 sq m was completed in Q2 2020. More than 300,000 sq m are scheduled for H2 2020. (46 ▶)

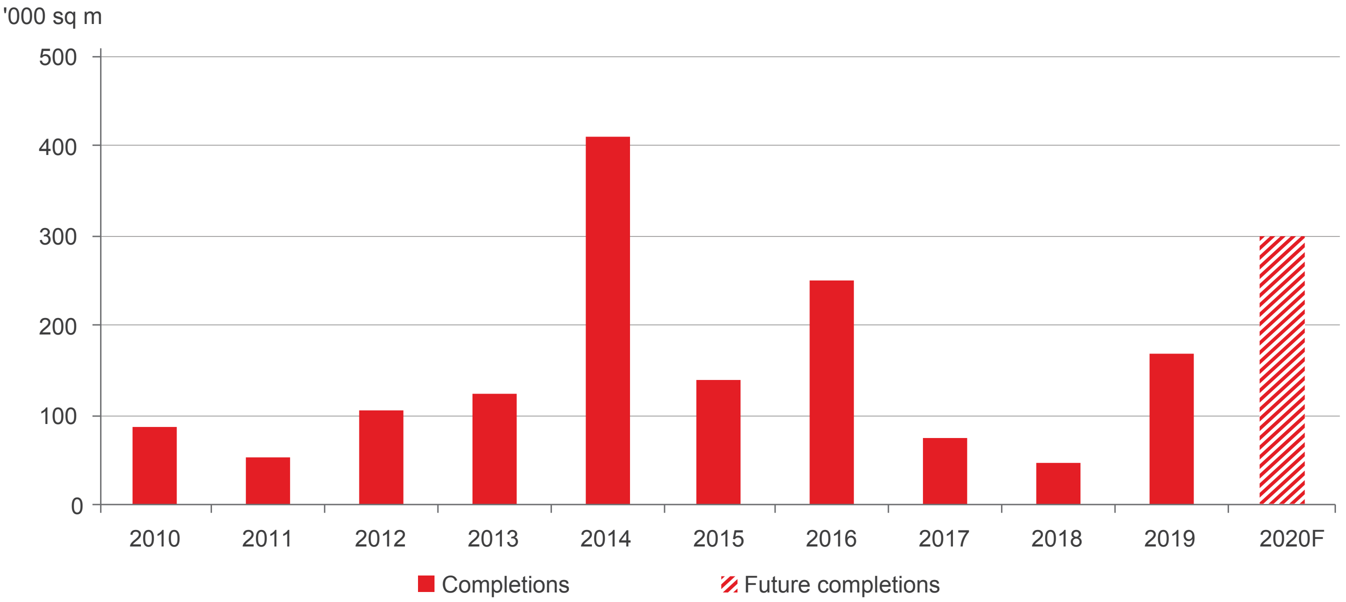
In existing warehouse complexes asking prime rental rates did not increase despite the positive dynamics of demand.

Stable demand for warehouse premises and minimum completions in Q2 2020 led to a further decline in vacancy rates.

As of the beginning of July, 89,000 sq m or 3.0% were vacant.

In the St. Petersburg warehouse market in H1 2020 the take-up volume was 22% higher than in the same period of 2019. Decreasing demand from retail companies is partially replaced by the growth of e-commerce. Also, the share of deals with manufacturing companies is growing.

46 ▶ COMPLETIONS IN THE ST. PETERSBURG WAREHOUSE MARKET



Source: JLL

Hot topic:

Rentals of retail property: challenges facing market players in a pandemic environment

Sergey Vershinin
Associate Partner, Rödl & Partner

During the second quarter of 2020 the real estate market underwent significant structural changes caused by the COVID-19 pandemic. The governments had to choose which party to the real estate rentals they would support. The tenant's challenges result from dropping sales, the necessity to adapt to new distribution channels and generally from having used vast leased spaces that are now becoming unaffordable. At the same time, the income of many landlords originates solely from rental payments from tenants on their property.

The Russian Federation decided to support tenants as the less protected party in the rental relationship. However, the relevant statutory regulations provide very few details, mainly highlighting the general direction of the planned actions and the intended outcome – and thus making it reasonable to assume that specific matters will be settled in courts and the affected businesses will have to seek extensive legal support during court proceedings prior to emergence of sustainable case law.

For now, the following explanations are available from the Government and the Supreme Court of the Russian Federation:

- Overviews of case law on certain aspects of application by courts of regulations and measures intended to prevent the spread of the new coronavirus infection (COVID-19) in the Russian Federation ("Overview 1" dated 21.04.2020 and "Overview 2" dated 30.04.2020);
- Federal Law no. 98-FZ dated 01.04.2020: On introduction of amendments to certain legal acts of the Russian Federation in matters of prevention and liquidation of emergency situations ("FZ no. 98");
- Resolution no. 439 issued by the Government of the Russian Federation on 03.04.2020: On establishing the requirements regarding terms and conditions of providing payment grace periods under real estate rental contracts ("GR no. 439").

Overview 1 only describes general approaches to the problem whereas Overview 2 is much more interesting for the purposes of this discussion. The other two regulations do not focus specifically on rentals of retail space and the suggested procedure has caused a round of criticism from lawyers because it had regulatory gaps.

The suggested measures apply to contracts concluded before the introduction of a high-alert regime by local governments (it was introduced in Moscow on 5 March and in many other regions on 19 March).

- After the introduction of such measures the tenant becomes entitled to request from the landlord a grace period on rental payments till 1 October 2020 and the landlord is obliged to conclude an additional agreement to this effect within 30 days of the request.
- The rental rates may be changed by an agreement between the parties at any time during 2020.
- The tenant is entitled to request a reduction of the rent payable for 2020 because of the impossibility to use rented space.

GR no. 439 establishes the terms and conditions for the grant of a grace period according to FZ no. 98:

- The arrears on rental payments are deemed to become due at the earliest on 1 January 2021 and must be settled before 1 January 2023 in instalments payable once a month – and not more often.
- The grace period shall be granted for the duration of the high-alert regime in the region for the entire amount of rent for this period and for 50 percent of rent for the period between termination of this regime and 1 October 2020.
- The landlord is not entitled to apply fines or any other sanctions for delays in payments during the grace period.

It should be noted however that this regulation comes in conflict with the mandatory regulations of the Russian Civil Code (Article 619) entitling the landlord to terminate the rental contract in case of two successive occasions of non-payment of rent by the tenant. The landlord made by law to grant the grace period concerned will become "tied up" to a bankrupt debtor.

The analysis of these regulations makes it possible to state that the agreement to grant a grace period is mandatory. However, the instruction to regulate this matter applying private law approaches enables the parties to conclude an agreement on conditions differing from those described in GR no. 439, provided they will not aggravate the tenant's position. The provision allowing amendments of the rent rate by agreement between the parties does not contain any new information because it is in line with the general regulations on rentals. It would be safe to assume that the discount on the rent rate will not be treated as unjustified in the pandemic environment and the government (tax authorities) will not accrue additional tax amount on the landlord granting such a discount.

A new version of FZ no. 98 was enacted on 8 June 2020 to regulate an even more radical situation. Where the tenant is a small or medium-sized business operating in a segment or an industry most affected by the virus, the tenant becomes entitled to request reduction of the rent rate. Then, unless the parties agree on such reduction within 14 days of the request, the tenant becomes entitled to withdraw from the rental contract during the period until 1 October 2020. In case of such withdrawal the tenant is not liable for any losses caused solely through the tenant's early withdrawal from the rental contract – whereas the contractual security deposit, if any, that has been paid to the landlord will not be returned to the tenant.

Apparently this amendment answers the question about sanctions applicable to the landlord refusing to sign an agreement on the grant of grace period or rent reduction contrary to the provisions of FZ no. 98.

Below we have made an attempt to provide solutions to certain practical problems.

SOLUTION OF THE PROBLEM REGARDING THE CONFLICT BETWEEN FZ NO. 98 AND THE GENERAL REGULATIONS OF THE RUSSIAN CIVIL CODE REGARDING BREACH BY A CONTRACTING PARTY

The Russian Civil Code (Article 328 Clause 2) states explicitly that where a party is in breach and it is obvious that the breach will not be remedied on time, the other party becomes entitled to suspend or totally discontinue the discharge of its obligation and to claim damages.

This article seems not to apply in a coronavirus situation because FZ no. 98 establishes more targeted and specific rules than the general regulations of the Russian Civil Code (this has been stated in the answer to Question no. 6 in Overview 2). This approach is only intended for risk allocation between the parties in a pandemic situation in a way that is fair in the opinion of the legislators.

In addition to the impossibility to make use of the rented property because of quarantine measures, the tenant must also prove that the rented property cannot be used for the initially agreed purpose; consequently, the purpose of property rental should be examined in more detail.

Article 328 of the Russian Civil Code applies to situations where the landlord has created obstacles for the tenant – whether in the absence or with abuses of any applicable statutory restrictions – leading to the impossibility to use rented property.

WHAT IS THE PERIOD FOR WHICH THE TENANT IS ENTITLED TO REQUEST REDUCTION OF RENT?

Although this period is the entire 2020 according to FZ no. 98, Overview 2 says in the answer to Question 5 that the reduction must be granted for a period beginning on the day when it becomes impossible to use rented property for its initially agreed purpose. The last day of this period will most probably be – for the purposes of court judgments – the day on which obstacles to use of rented property cease to exist, meaning the day when the quarantine restrictions are lifted. This period will possibly include an additional grace term required for a prudent businessman to resume the company's operations.

WHAT DOES THE PHRASE "IMPOSSIBILITY TO USE THE PROPERTY" ACTUALLY MEAN?

It should be taken into account that many tenant companies have not fully discontinued using their rented space, even though they had to make some significant changes affecting the nature of their operations. Is the tenant entitled to request any reduction of rent in this situation?

FZ no. 98 guarantees the tenant the entitlement to rent reduction, provided full impossibility to use rented space for its intended purposes. However, Overview 2 makes it possible to assume that the regulation also applies to situations of a forced change to the company's core operations. It is emphasised that the rent is subject to reduction beginning on the day when use of rented space becomes impossible according to its initially agreed purpose.

This regulation sees arguable, but the tenant can make use of the general rule. Article 614 Clause 4 of the Russian Civil Code entitles the tenant to request a pro rata reduction of rent where the terms and conditions of use agreed in the rental contract have significantly deteriorated for reasons not attributable to the tenant.

ARE THERE ANY RECOMMENDATIONS REGARDING DETERMINATION OF THE RENT REDUCTION SIZE?

Overview 2 states that the rent reduction size is to be defined based on customary reductions granted in such situations, but the situation at hand is far from common. Courts trying such disputes will most probably examine changes of the market rent rates charged for similar property during the period in dispute. The rent rate agreed between the parties is not always a market rate. So it would be reasonable to determine the benchmark market rent reduction rate for the period in dispute and to apply this rate to the rent agreed by the parties.

To sum up, all parties to rent of retail space will face hard times. The tenant's position is strengthened through grant of a grace period, but tenants will ultimately have to settle their debts in any case. Landlords will lose their income or may even go bankrupt under the worst case scenario. Courts will have to develop sustainable case law because even Overview 2 has not filled all gaps in the applicable regulations. Lawyers can expect some hard work in courts and negotiations to agree on new rental terms and conditions.

Hot topic:

The future of work(space)

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Ksenia Panzhinskaya
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Due to the global COVID-19 pandemic, most companies were disrupted overnight by the necessity to shift their workforce to remote working. Some were already prepared for this, having invested in appropriate technology and already nurtured a flexible working culture, others – less so. Nevertheless, the global work-from-home experiment has proven itself successful, for the most part, and has prompted many employers to consider shifting their workforce to remote working on a part-time or full-time basis as a direct result of the COVID-19 crisis.

Whether or not to return to the office remains an open question for many, but major employers are seriously considering seizing this opportunity to cut costs by saving on expensive office rents without compromising productivity. Inevitably, this sentiment may translate into a short-term decrease in demand for office space and increased vacancies. Moreover, tenants will likely be initiating rental agreement renegotiations.

In the long run, however, we may see increased competition among owners and developers, as tenant companies strive to optimize their corporate real estate portfolios and shift their focus and preferences towards more innovative, flexible, safe and comfortable office spaces. Employee wellbeing will likely be placed at the forefront of these strategies, going beyond the standard requirements for fresh air, natural lighting and intensive cleaning and disinfecting regimes. We now understand that this "new normal" calls for a more radical reimagining of the office and the deployment of serious technologies to create truly healthy and safe buildings. These technologies may include biometric hardware (temperature scanners at buildings' entries), smart security (restricting employee access to certain areas or on certain days and using sensors to supervise compliance), AI and analytics (to ensure compliance with social distancing requirements by assigned seating, split shifts or staggered starts) and robust building management systems (to monitor fresh air and humidity rates, etc.). As we now know, "health is the new wealth".

Furthermore, the office itself is likely to be reimagined. Thinking back on the recent past, one might remember the tendencies towards centralized offices that host the majority of workforce in one place, as well as crammed open spaces with somewhat limited strictly functional axillary facilities (meeting rooms, kitchens, etc.). These tendencies are all being revolutionized to suit the new role of the office space, which is no longer a gathering spot for day-to-day operations, but rather a collaborative and creative space with unique technologies. The mass remote working experiment has revealed that while some tasks, such as writing reports, training, performing routine operations, etc. can often be performed effectively from home, other activities, such as brainstorming and performance reviews, are more efficient in the office. Furthermore, long-term remote working can hinder important aspects of company culture, like trust, through reduced frequency and quality of interpersonal communications, and eventually proactivity, as the lack of immediate day-to-day interactions within the team restructures responsiveness into reactive work upon request. Some companies, depending on their nature of business, will be less susceptible to these shifts. However, it is still uncertain, whether those in the more creative/collaborative sectors of economy will thrive under remote working conditions. It is also worth noting the numerous less immediate, but no less important, considerations such as psychological wellbeing, teamwork and the feeling of belonging, corporate culture, socialization, etc.

As such, while companies may seek to cut back on office space and reduce operating costs, this cannot be achieved instantly across the board (due to long-term rental agreements and, in some cases, ownership considerations). The traditional office is not going to disappear altogether. What we can surely expect is the repurposing of the office space to fulfill collaborative needs and the possible reimagination of centralized offices into smaller satellite locations that provide employees with suitable and equipped workspaces while alleviating lengthy commutes.

When evaluating the costs and benefits of remote working, companies must consider four important aspects. The first is people – in the recent past we've seen human capital rise steadily to the forefront. Generations, comfort, motivation, flexibility and workforce socialization are key indicators of company success. Secondly, business processes must be carefully reviewed for interconnectivity, communication and document flow, access to information resources and decision-making processes by business blocks in order to ensure uninterrupted workflow, operational resilience and seamless transition to remote working arrangements. The following considerations must be taken into account before making the decision to transition to a remote working scheme. Companies must objectively assess what can and cannot be performed from the home office without impairing the efficiency of business operations. The third important aspect is IT. Naturally, a company's infrastructure must be strong enough to support remote connections and access to internal and restricted resources, withstanding any potential cyber-security risks. Hardware is another important consideration. The employer must ensure that all remote employees are adequately equipped with the necessary laptops, desktops, printers and stable internet connections to perform their required tasks. The fourth and final consideration is physical real estate. This inflexible asset must somehow account for all of the aforementioned considerations and cater to the company's social and motivational needs. It must guarantee the safety and wellbeing of those who do visit the office and serve as a technical and infrastructural hub (for correspondence, stocks and deliveries, archives, servers, printing, etc.) while also maintaining the company status as a venue for client meetings and external events. Prior to embarking on a more permanent remote working scheme, it is highly recommended that companies hire an external advisor with an independent view, holistic approach and expertise in all four of the aforementioned aspects to run diagnostics and design an implementation strategy.

None of the aforementioned information is revolutionary – the market has been discussing and testing these ideas for several years now. However, the real estate sector, which has historically been rather conservative, rigid and inflexible in nature, has been slow to uptake and adapt to the previously forecasted trends. Few changes had been put to practice prior to the COVID-19 crisis. Now, the pandemic serves as a catalyst, accelerating the inevitable sector changes which have long been at the tip of everyone's tongues.

Hot topic:

The consequences of a lessee's refusal to accept property under a lease agreement: the new practice of the Supreme Court of the Russian Federation

Andrey Zharskiy
Partner, Head of Real Estate, Advocate, PhD, ALRUD

Aleksey Kalinkin
Associate, Real Estate, ALRUD

On June 26th 2020, the Ruling of the Supreme Court of the Russian Federation no. 305-ES20-4196 was published. The Decision is dedicated to important issues of forcing the lessee to fulfill its obligations to the lessor, under a real estate lease agreement. The legal position of the Supreme Court should be taken into account when structuring lease transactions, including the built-to-suit lease agreements.

This is especially important when we speak about the remedies of the lessor, in cases of a lessee's refusal to accept the subject of the lease.

Russian law provides for such a remedy, as the enforcement of obligations by a breaching party (specific performance). However, it is not enforceable in the case when the lessee refuses to accept the rented property, according to the position of the Supreme Court of the Russian Federation.

FACTUAL BACKGROUND OF THE CASE

The lessee and the lessor had entered into a short-term, real estate lease agreement. Under the terms of the agreement, the lessee was obliged to accept the premises by August 27th 2018, and pay the first part of the security payment (deposit) – by September 9th 2018.

On August 19th 2018, the lessee sent the lessor a notice of termination and refused to sign the acceptance and transfer certificate in respect to the premises, despite the provisions of the lease agreement. The lessee has also refused to pay the security payment.

Since the lease agreement did not provide for a right of the lessee to withdraw from the agreement unilaterally, the lessor filed a claim to compel the lessee to accept the premises, to pay the security payment and a penalty for the delay of payment.

POSITION OF THE LOWER COURTS

The court of first instance satisfied the lessor's claims in full, saying that the lessee shall accept the premises and pay a security payment (articles 309 and 421 of the Civil Code of the Russian Federation). It concluded that there was an enforceable obligation of the lessee to accept the property. Since it failed to perform this obligation, the court could compel the lessee to perform it, in the manner prescribed by the lease agreement.

The courts of appeal and cassation have upheld this decision.

WHAT DECISION DID THE SUPREME COURT OF THE RUSSIAN FEDERATION MAKE?

The Supreme Court disagreed with the lower courts. According to the Supreme Court position, because of the nature of the obligation to transfer the leased property, it cannot be enforced against the lessee, using the claim of the lessor under Art. 308.3 of the Civil Code. If the lessor does not fulfill its obligation to transfer the property, then the lessee may have recourse to a claim for specific performance and enforce the transfer of the leased premises under the lease agreement. Specific performance, however, is not available for the lessor if the lessee refuses to accept the property. Thus, in this case, the lessor has to use other remedies.

In this situation, the lessor has only a few remedies (if no other remedies are agreed, between the parties, in the lease agreement):
- termination of the contract, at the initiative of the lessor, in court;
- compensation for damages caused by the unlawful refusal of the lessee to accept the leased premises (which is considered by the Supreme Court as the creditor's delay, within the meaning Art. 406 of the Civil Code).

In relation to the security payment, the Supreme Court concluded that, as the lease agreement provides that this payment might be set-off against damages caused by the lessee, the court cannot compel the lessee to make a security payment, in addition to compensation of damages. Thus, in this particular case, the appropriate remedy is recovery of damages.

Taking into consideration the above-mentioned decision of the Supreme Court, the parties to the lease agreement, especially in case of built-to-suit lease agreements, or agreements in respect to future leased premises, shall carefully consider their relationships and agree specific remedies in order to address and mitigate respective risks.

We may recommend the following to the lessors:
- The contract should provide for a penalty (neustoyka) in a case of lessee's refusal to accept the rented property. Such a penalty can be established as a lump sum, or accrue for each day of delay.
- It is recommended to introduce provisions regarding the right of the lessor to unilaterally withdraw (terminate) from the contract, in case the lessee refuses to accept the leased property, or does not accept this property, during the prescribed period. The contract shall provide the right of the lessor to claim a penalty (neustoyka) as a consequence of such termination of the contract (whether in addition, or in lieu, to the lessor's damages, caused by termination of the lease contract). In such a case the lessor should have a right to retain the security payment (if paid prior to termination) on account of such penalty (neustoyka).
- Lessors should also consider the possibility to obtain an irrevocable power of attorney from the lessee, providing for a right to sign an acceptance certificate, on behalf of the lessee. It will significantly reduce the lessor's risks associated with the lessee's refusal to accept the rented property.
- The lease agreement should specify the procedure of transfer of the rented property in greater detail, including issues such as notifications, eliminating defects identified by the lessee, the list of documents to be signed at the transfer, period for transfer and so on. The lessor should strive to eliminate any uncertainty regarding the transfer of leased property. Some provisions on the unilateral transfer of property by the lessor, in a situation where the tenant is passive, might be introduced.

Hot topic:

The story of a gas network with the happy end

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Commercial real properties, such as warehouses, industrial and office buildings, are very often heated by natural or liquefied gas-fuelled boilers. The gas is brought to the boiler houses along gas consumption networks that, up to the point of connection to the gas lines of the gas-distribution organisation, also usually belong to the owners of commercial real properties. We have found that such owners often tend to forget about Russia's special legislative requirements on their gas networks and there can be unfortunate consequences if these are ignored. Let's take a look at these requirements, their possible adverse impact and how to avoid this.

WHAT MUST UNPROFESSIONAL OWNERS OF GAS NETWORKS BEAR IN MIND?

Gas consuming lines leading to buildings are hazardous industrial facilities (HIF) if the pressure of the natural/liquefied gas in them exceeds 0.005 Mpa. Depending on the pressure in the pipe, they may be included in HIF hazard class II or III. The boiler house of a building (whether it is part of the building or a separate unit) may also be classed as an HIF, depending on the quantity of hazardous substances inside it.

Remember that operation of HIF of hazard classes I, II and III requires a licence.

Operation of an HIF without a licence might entail liability under Article 171 of the Russian Federation Criminal Code for engaging in unlicensed business, should such actions be associated with deriving large or very large income or cause major damage[1]. The potential scale of criminal liability in this instance ranges from fines to a five year prison term. The limitation term for imposing criminal liability is six years from when the crime was committed, meaning from when a licence was eventually obtained. The licence requirement for operating an HIF and its consequences fully apply to owners of gas networks and boiler houses attached to HIF.

Another point is that the owner of an HIF has to observe special industrial safety rules, including: registering the HIF on a special register, concluding an agreement with an emergency rescue service and an HIF-owner civil liability insurance agreement, and so on.

Operation of gas networks and boiler houses that are HIF in breach of the industrial safety rules, such as without a licence, might be suspended or discontinued through an administrative or civil-law procedure, which will adversely affect the gas supply (and, as a consequence, the heat supply) to the real property.

WHO IS RESPONSIBLE FOR OBSERVING THE SAFE OPERATING RULES?

It is the owner of HIF gas networks and boiler houses that is responsible for obtaining a licence and observing the industrial safety rules. This means the person that either owns the HIF or holds it on other legal grounds and that uses the

[1] Art. 171 of the RF Criminal Code provides for liability for doing unlicensed business producing an income of over RUB 2.25 m or causing harm of over RUB 2.25 m.

HIF, possibly the owner or lessee of the HIF. It is important for the given person to possess and be able to use the HIF.

WHAT MISTAKES ARE MADE IN OPERATING GAS NETWORKS AND BOILER HOUSES?

Owners of HIF gas networks and boiler houses often make the mistake of hiring an organisation to exercise operational control over the state of the lines and the boiler houses, maintain and repair them, thinking that they have thus handed over the HIF "for operation" by a professional organisation so they do not need an HIF operating licence themselves. This is a common misconception: unless full possession and use of the HIF is handed over to the "operating" organisation, it is not deemed to be its holder. In this case, the true owner of the HIF remains responsible for its operation so the HIF operating licence is needed by this entity, not the engaged "operating" organisation.

The second most common error is to lease the HIF gas networks and boiler houses fictitiously to third parties. This means the lease is not intended for transferring them into actual possession and use for gaining benefits. For instance, such a lease does not provide for possession of the gas service lines and boilers to be transferred. Or there is no true economic purpose behind such a lease: the subject is leased out but the lessee does not use it. In contrast, a real lease for property must have an economic purpose (for example, a boiler house and gas networks are leased out, the lessee operates the boiler house and supplies hot water to the HIF owner). Sham leases are concluded, often at a nominal price, merely for the sake of appearances and without any intention of creating legal consequences. Their purpose is to conceal actual operation of the HIF by its owner, making them sham agreements and, as a consequence, transactions that are null and void (Art. 170 of the RF Civil Code). If this is the case, there is a risk that the entity actually possessing the HIF (i.e. its owner) might be recognised as de facto operating a HIF without a licence.

There is a third common mistake: lease of the gas pipelines and boiler house to an entity lacking an HIF operating licence (even if this is a true lease and the lessee actually uses the leased HIF). The HIF owner is responsible for what happens to the HIF and must manage it to the benefit of the person entitled to use the HIF, otherwise the HIF owner might also, alongside the lessee, be held liable for making improper use of the HIF.

WHAT ARE THE POSSIBLE SOLUTIONS?

Holders of gas networks and boiler houses classed as HIF are recommended to follow these rules:

- Ensure that the owner of the gas networks and boiler houses has a licence for operating HIF and complies with the industrial safety rules. These matters should be handled before or at the time operation of the gas service lines and boiler houses is launched, depending on the procedure for obtaining the requisite permits.
- If it is decided to lease out the HIF gas networks and boiler houses, make sure that the lessee has an HIF operating licence for the given address or that it obtains such a licence in the near future. Remember that lease of gas networks and boiler houses must have a business purpose, clearly presupposing subsequent conclusion of heat supply agreement(s) by the lessee of the facilities as a heat supply organisation.
- If your company purchases gas networks and boiler houses as part of other properties, after acquiring the title to these and until your company obtains an HIF operating licence, we recommend having the seller of the property retain possession and use of these assets, and concluding a temporary heat supply agreement with them. As an alternative, if the period for obtaining the licence coincides with the end of the heating season, operation of the gas networks and boiler rooms could be suspended until the HIF operating licence is obtained and observance of the other industrial safety rules ensured.

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, the State Duma and other relevant governmental bodies.

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