



ASSOCIATION OF EUROPEAN BUSINESSES IN THE RUSSIAN FEDERATION

Current Cost of an Office Fit-Out In a Downturn

**Organized by the
AEB Real Estate Committee**

28 May 2009,
Hotel Marriott Tverskaya, Moscow



JONES LANG
LASALLE

Moscow *Office* Market

Q1 2009

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Moscow office market snapshot, Q1 2009

	Class A	Class B+	Class B-	Total
Modern office stock:	1,427,560	5,615,060	4,010,200	11,052,820
Completions, Q1:	145,600	547,000	292,020	984,620
Take-up, Q1:	42,080	234,430	78,130	354,640
Availability:	272,350	1,022,860	579,650	1,874,860
Vacancy rate:	19.1%	18.2%	14.5%	17%
Prime base rents* – (USD/sq m/year):				750-1,000
Base rents – (USD/sq m/year):	700-800	600-650	350-400	
Operating expenses (USD/sq m/year):	110-150	100-120	70-90	
Prime yields:				11.5-12%

All figures are in square metres unless otherwise noted

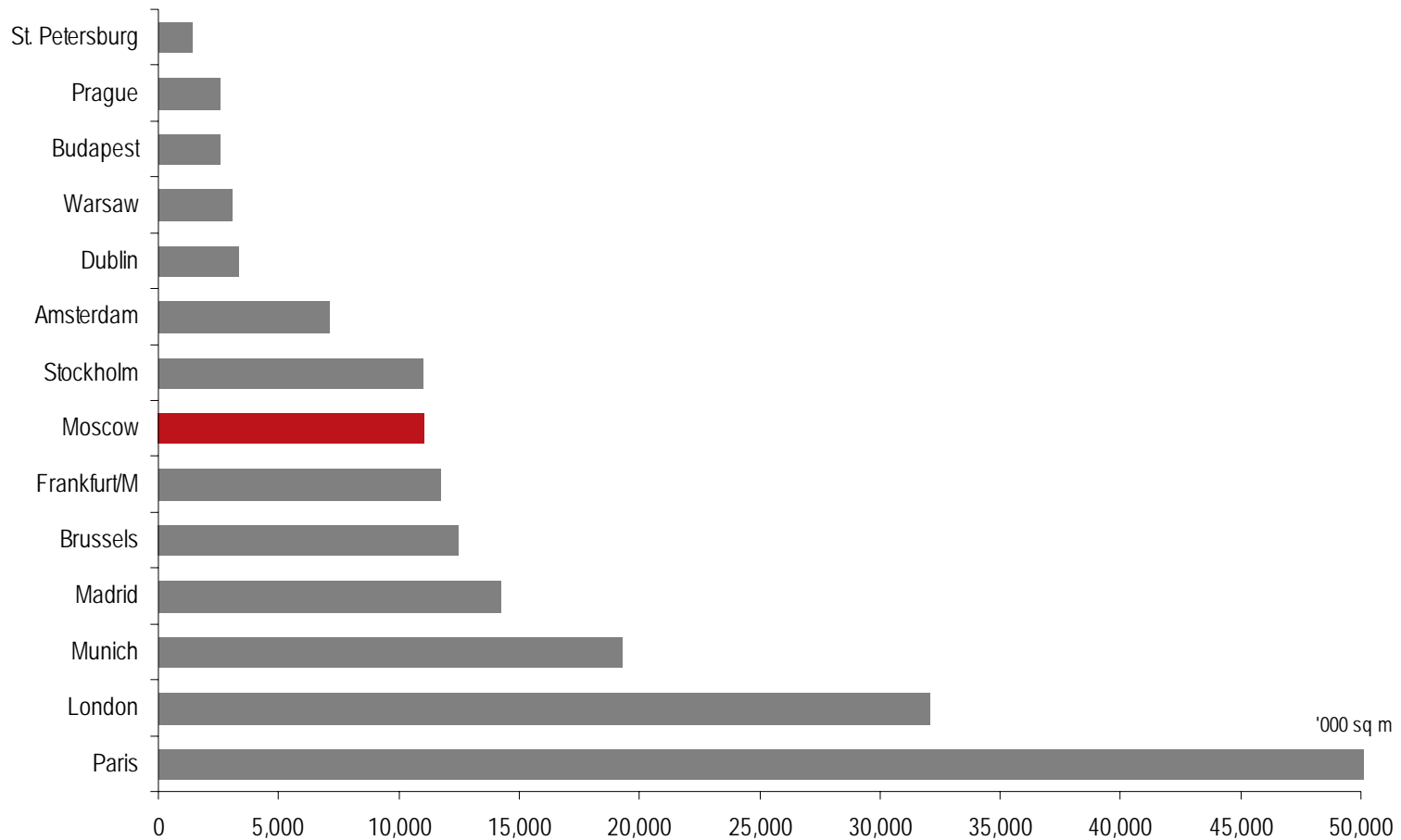
Source: Jones Lang LaSalle

* These rents are applicable to high quality buildings situated within the Kremlin area

Office supply



Modern office stock: European benchmarks, Q1 2009

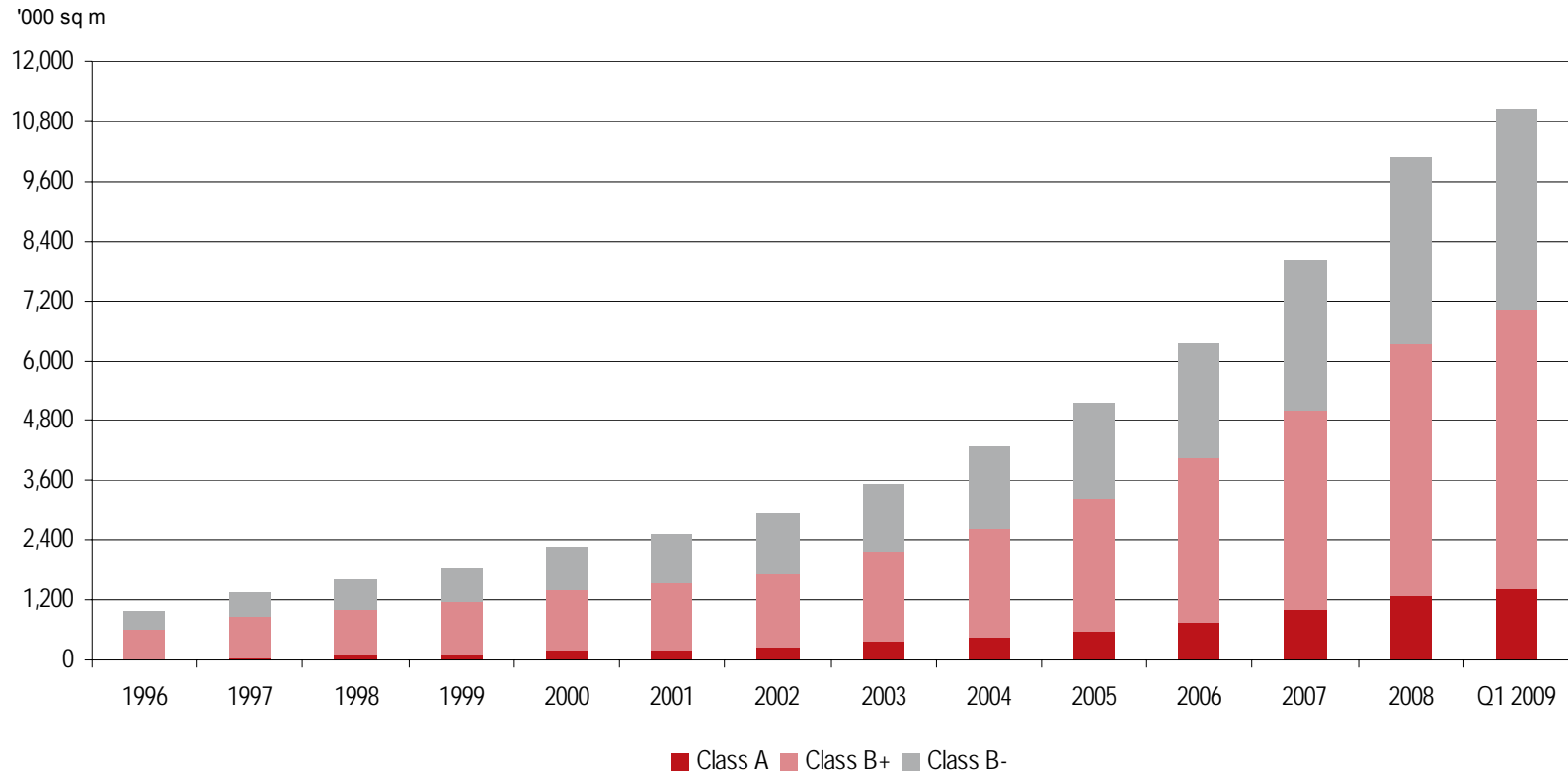


Stock of high quality office space in Moscow is considerably smaller than in major European capitals.

Source: Jones Lang LaSalle

"Modern" Office Stock = Class A, B+ & B-

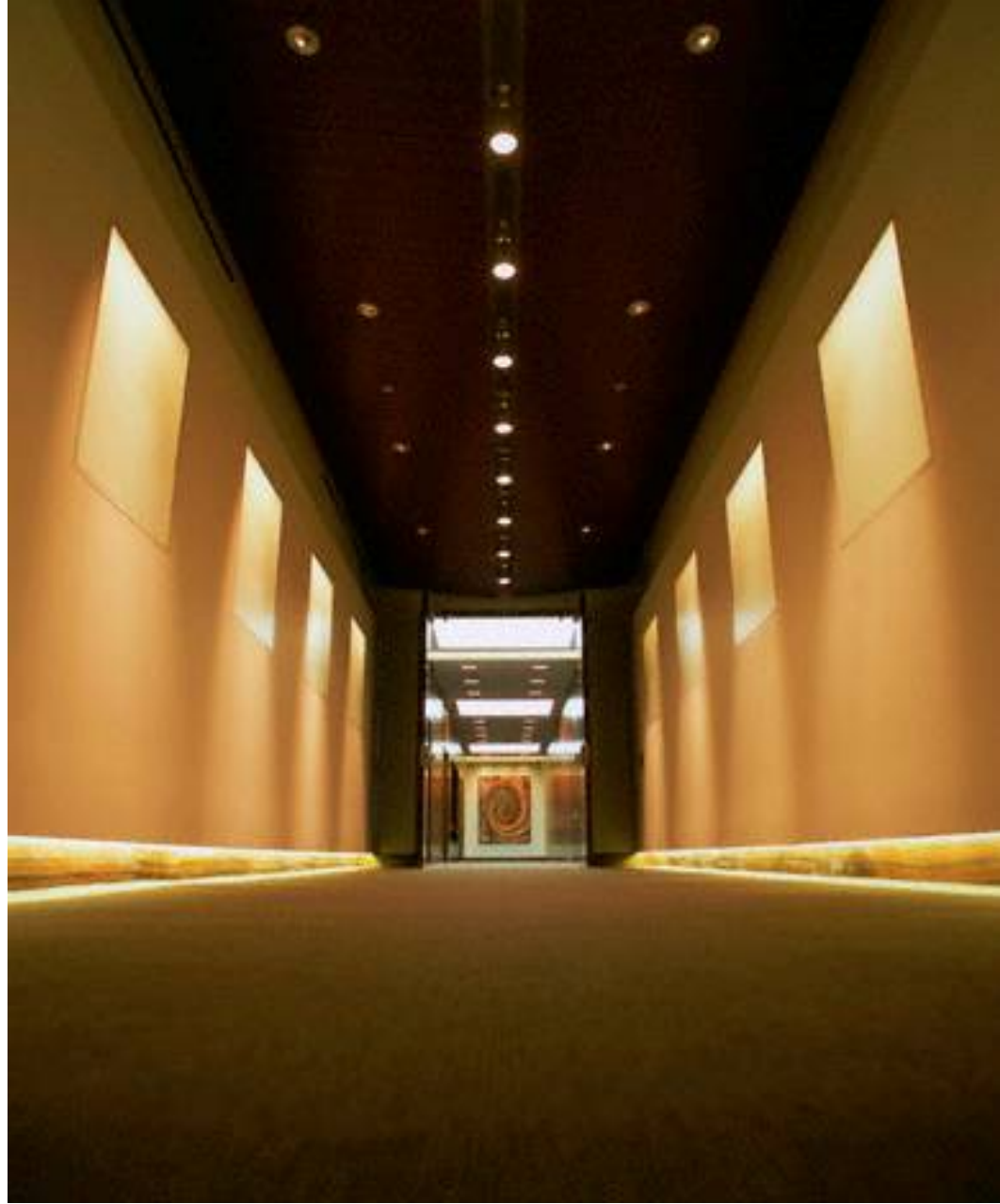
Class A, B+ and B- office supply dynamics



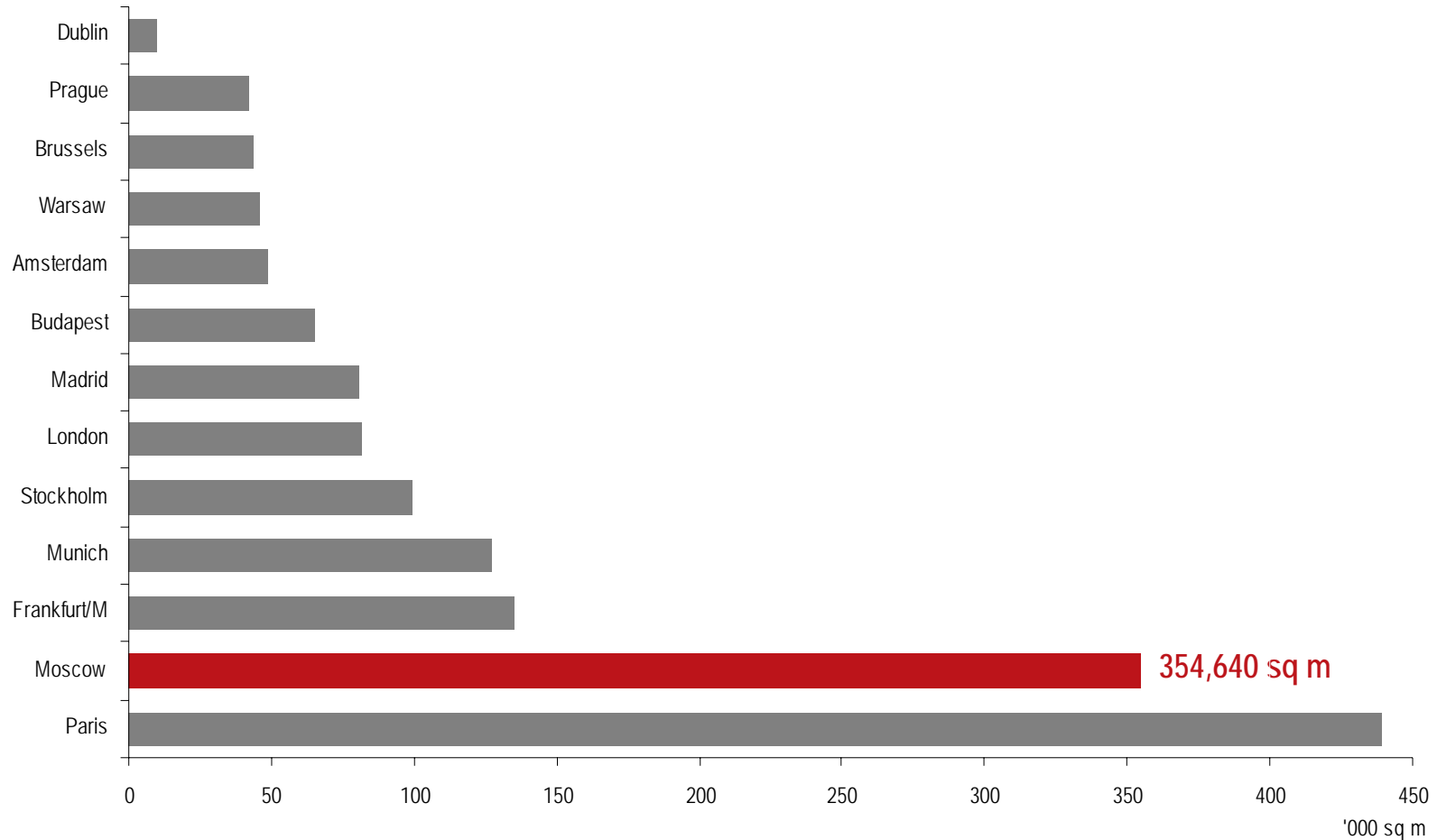
The Moscow office market remains one of the most rapidly developing in Europe. Although the crisis has forced developers to postpone planned projects, significant new supply will enter the market in 2009-2010.

Source: Jones Lang LaSalle

Office demand



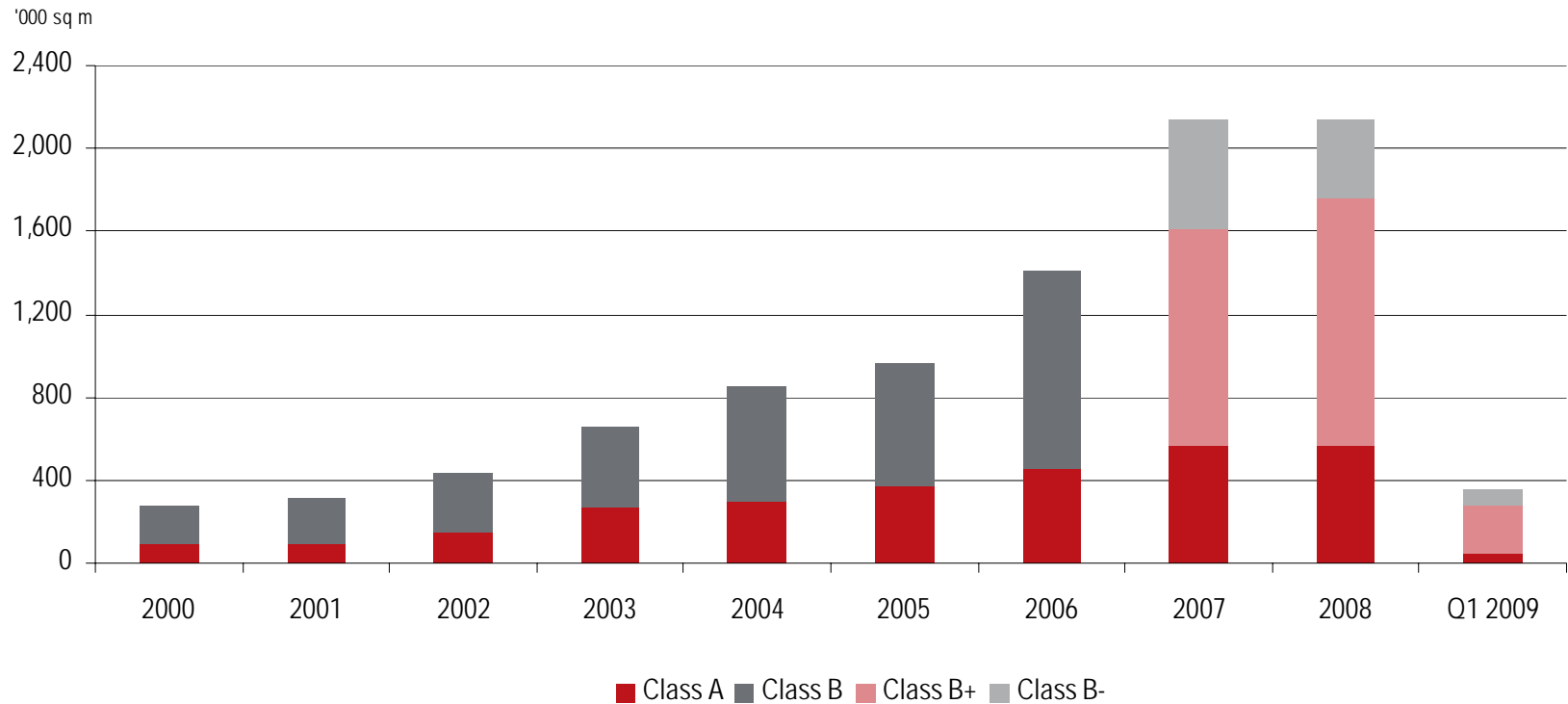
Modern office take-up across Europe, Q1 2009



In Q1 2009 Moscow had the second largest take-up in Europe.

Source: Jones Lang LaSalle

Modern office take-up dynamics

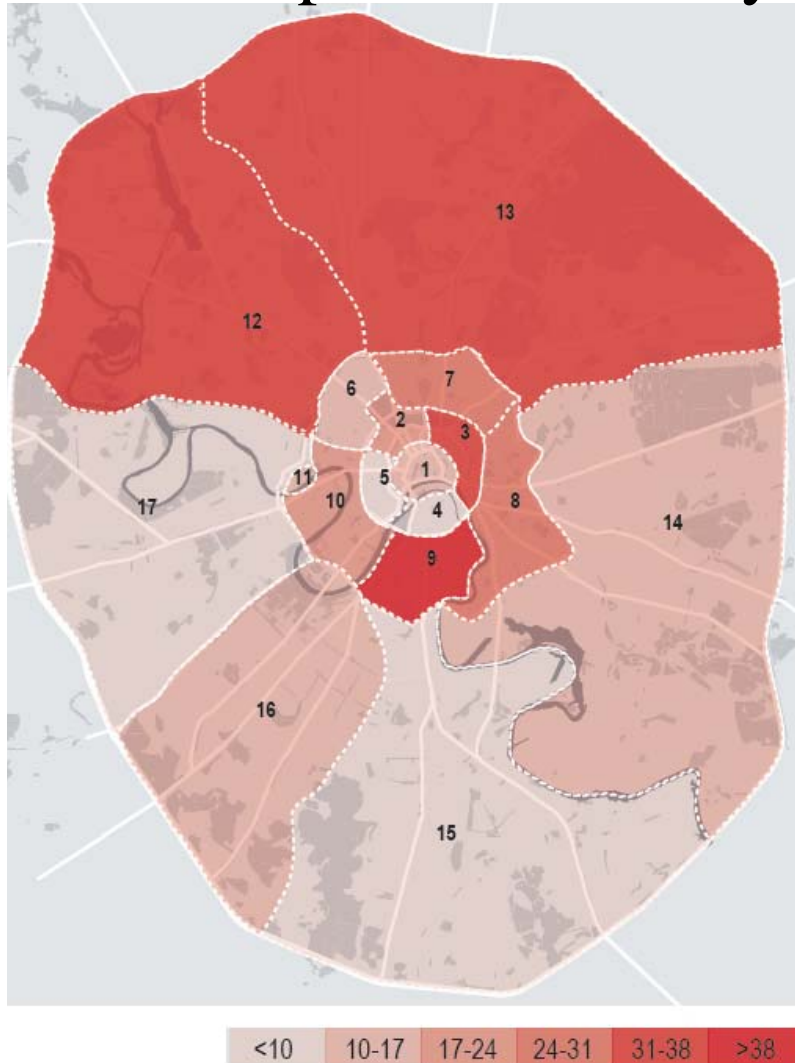


The crisis will significantly reduce office take-up in 2009. It will return to 2007-2008 levels only after 2011.

Source: Jones Lang LaSalle

*At the end of 2006 the office classification was reviewed by the Moscow Research Forum and new standards were adopted

Take-up breakdown by submarket, Q1 2009



All figures in '000 sq m

- Moscow take-up in Q1 2009 was 354,640 sq m
- 48% of take-up was concentrated in Zone 2 (between the Garden Ring and TRR*)
- Take-up decentralization follows stock decentralization
- The following submarkets comprised the majority of Q1 2009 take-up:
 - 9. South between GR and TRR (18%)
 - 3. NE inside GR (9%)
 - 13. NE outside TRR (9%)

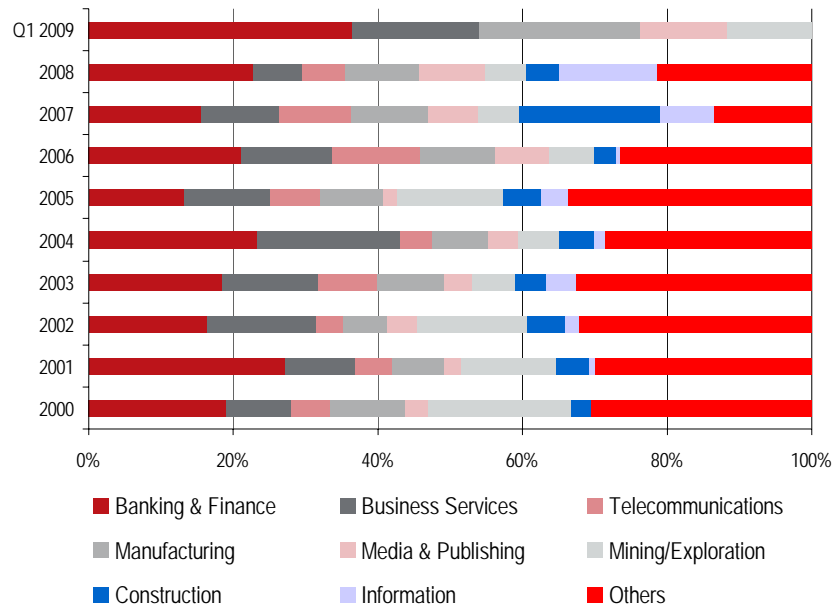
Zone 1 (inside the Garden Ring)	Zone 2 (between the Garden Ring and TRR)	Zone 3 (outside TRR)
1. Kremlin area	6. NW	12. NW
2. NW	7. NE	13. NE
3. NE	8. East	14. East
4. South	9. South	15. South
5. West	10. West	16. SW
	11. Moscow City	17. West

Source: Jones Lang LaSalle

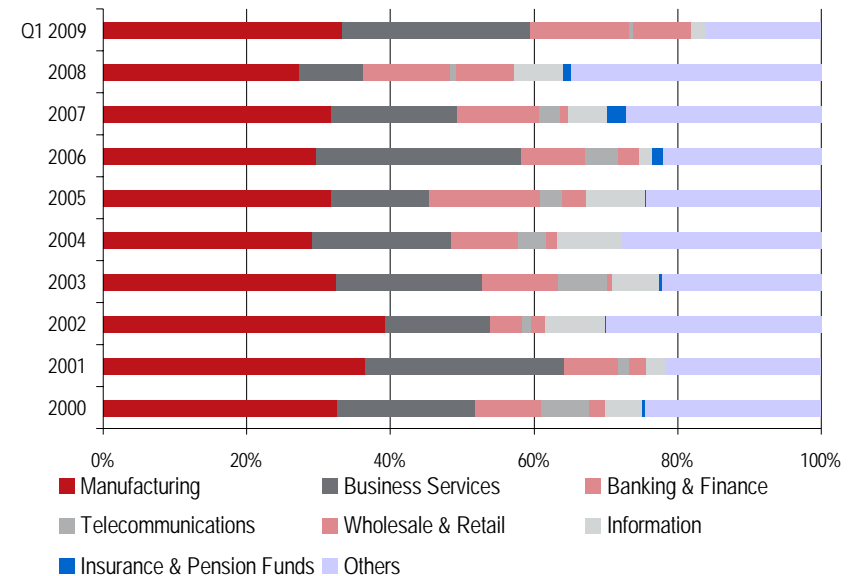
* TRR- Third Ring Road

Take-up breakdown by business sector

Russian companies
(61% of take-up in Q1 2009)



International companies
(39% of take-up in Q1 2009)



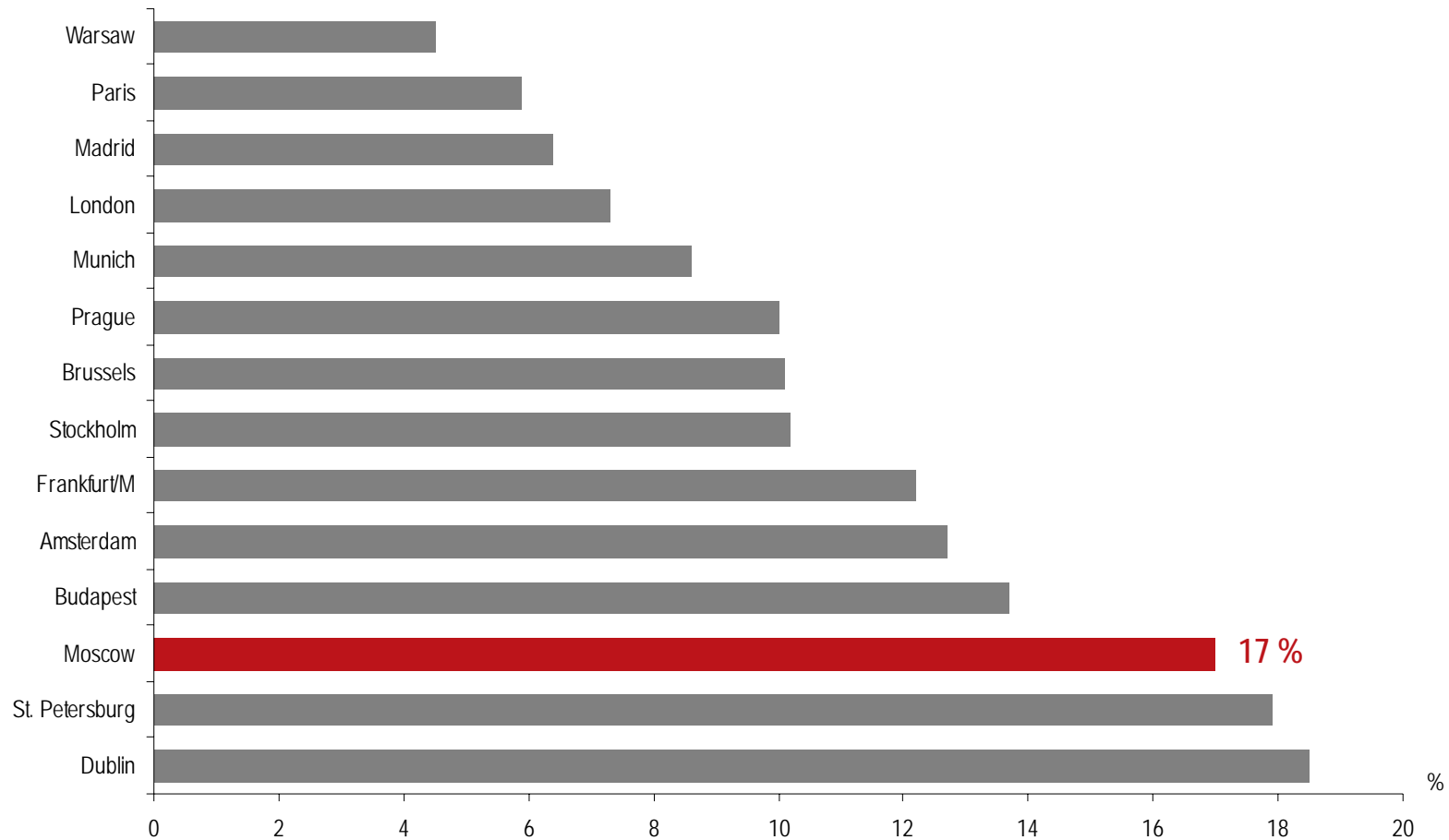
International manufacturing companies as well as Russian banking and finance companies dominated take-up activity in Q1 2009.

Source: Jones Lang LaSalle

Supply/demand balance



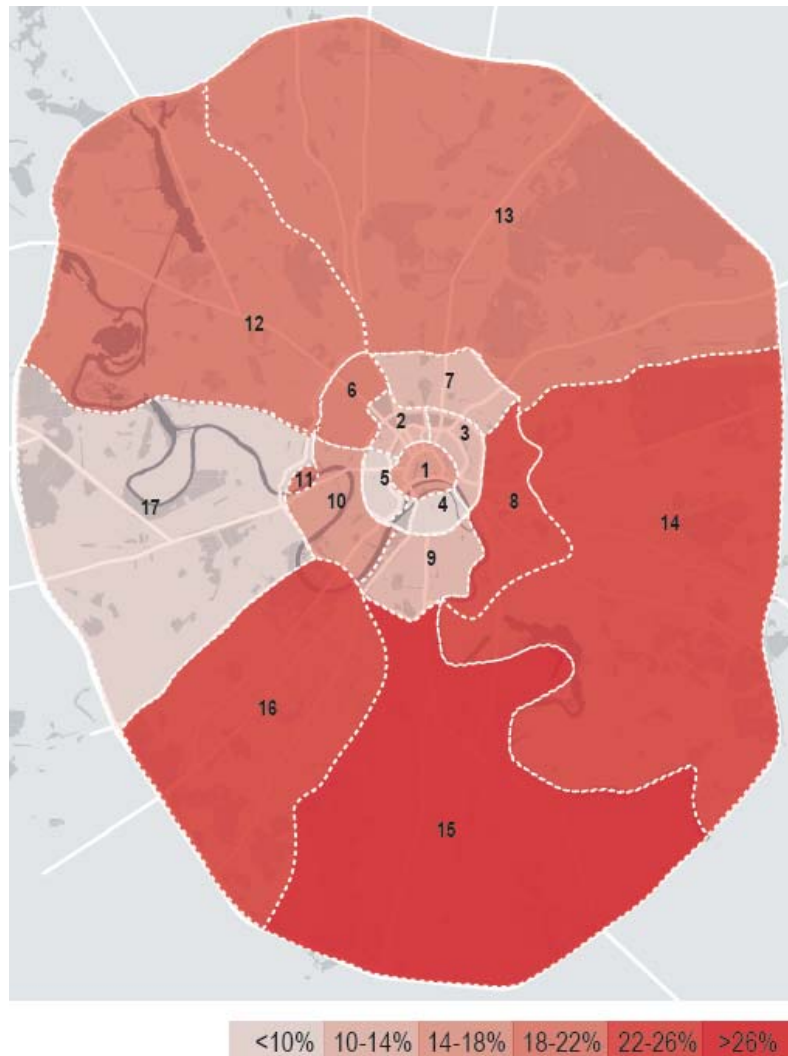
Office vacancy rate benchmarks, Q1 2009



High volume of completions entering the market against weakening demand raised the vacancy rate to 17%.

Source: Jones Lang LaSalle

Vacancies by submarket, Q1 2009



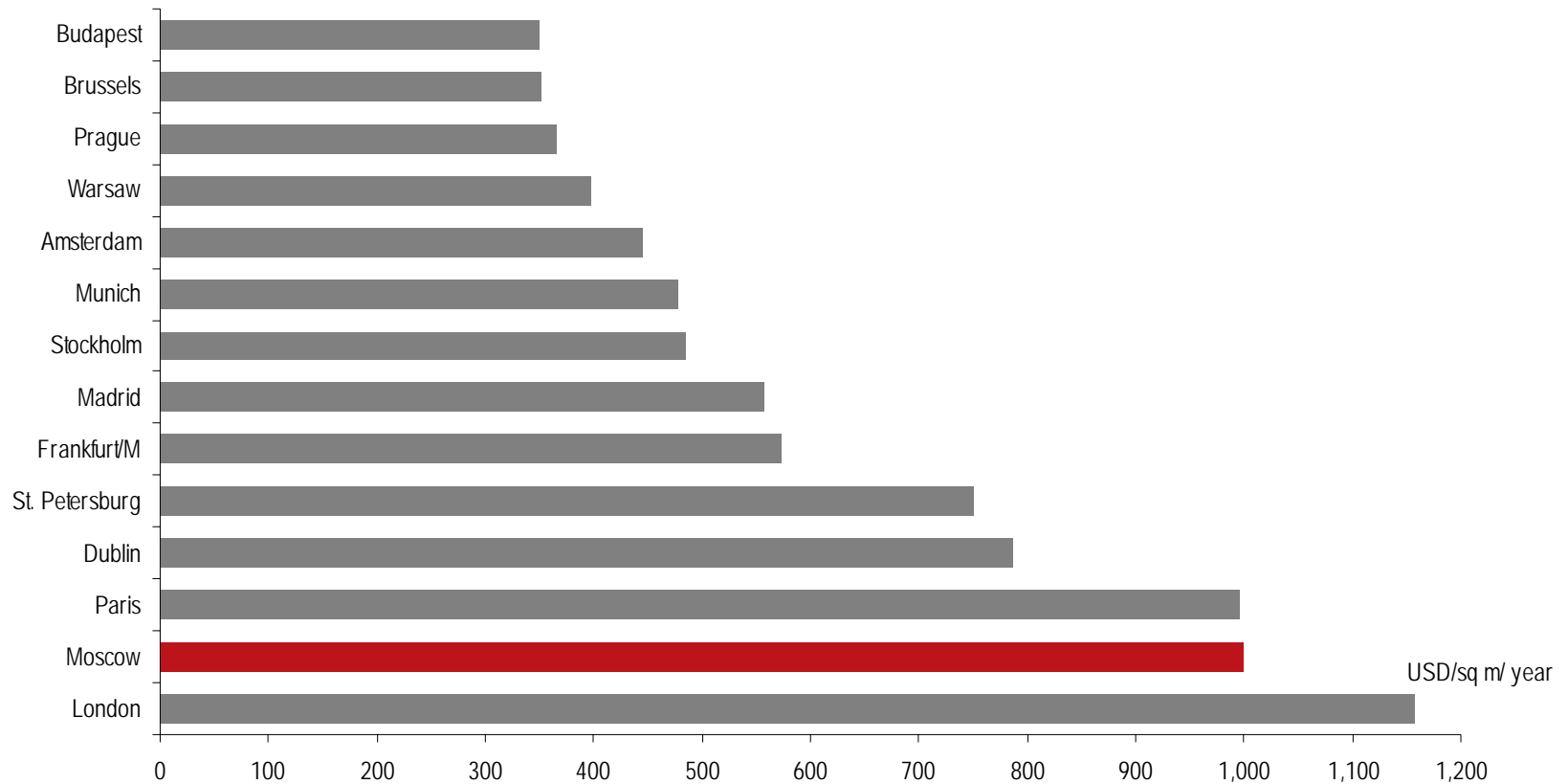
- The average vacancy rate in Moscow in Q1 2009 was 17%.
- Vacancy rates in the majority of districts inside the Garden Ring and in the western direction are below the average. This reflects higher demand for centrally located offices and premises in the west.

Zone 1 (inside the Garden Ring)	Zone 2 (between the Garden Ring and TRR*)	Zone 3 (outside TRR)
1. Kremlin area	6. NW	12. NW
2. NW	7. NE	13. NE
3. NE	8. East	14. East
4. South	9. South	15. South
5. West	10. West	16. SW
	11. Moscow City	17. West

Source: Jones Lang LaSalle

* TRR- Third Ring Road

Office prime base rents benchmarks, Q1 2009

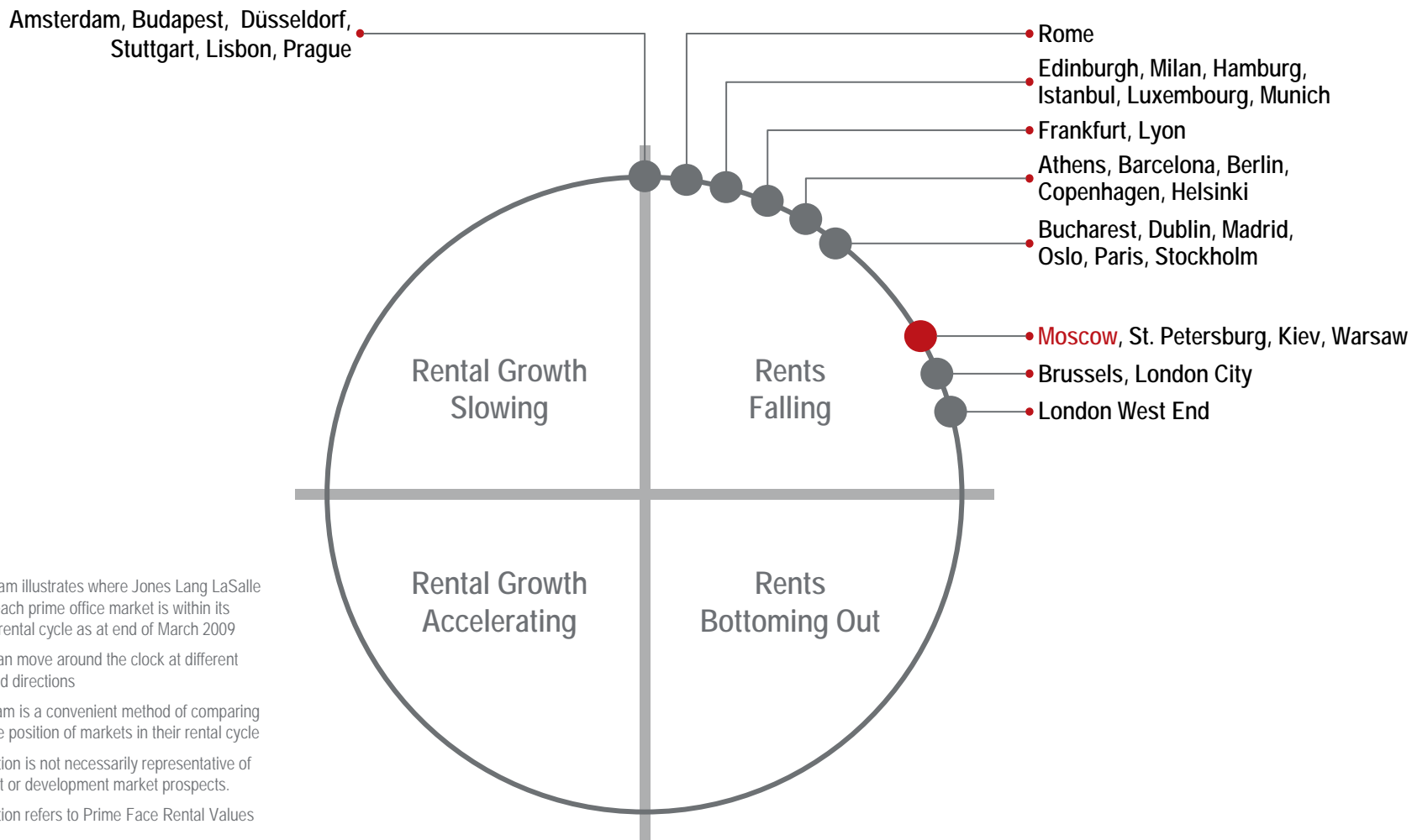


The level of prime base rents in Moscow remains one of the highest in Europe.

Source: Jones Lang LaSalle

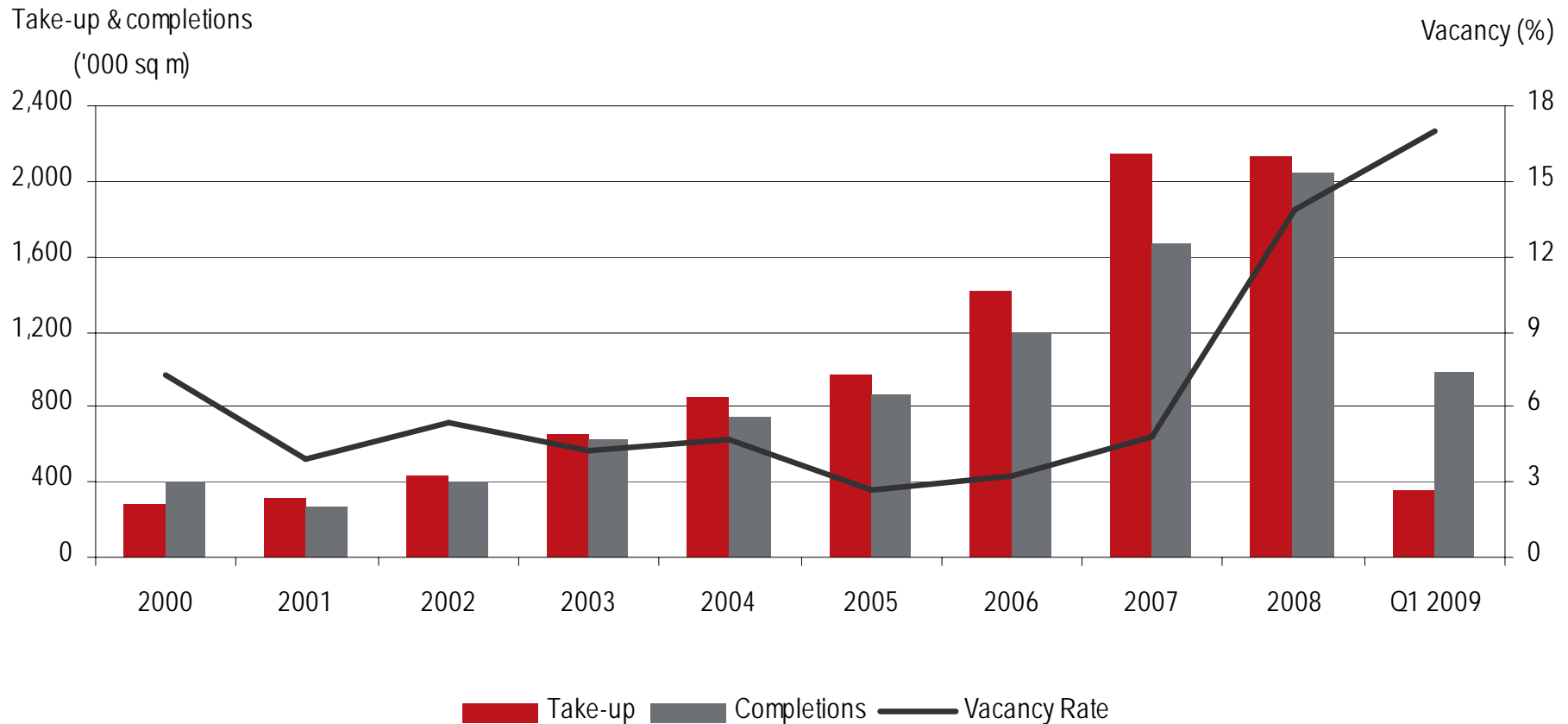
* Prime base rents are base rents (excluding VAT and operating expenses) for units of 1,000 sq m in existing prime buildings (without fit-out)

European Office Property Clock, Q1 2009



Source & Copyright: Jones Lang LaSalle IP

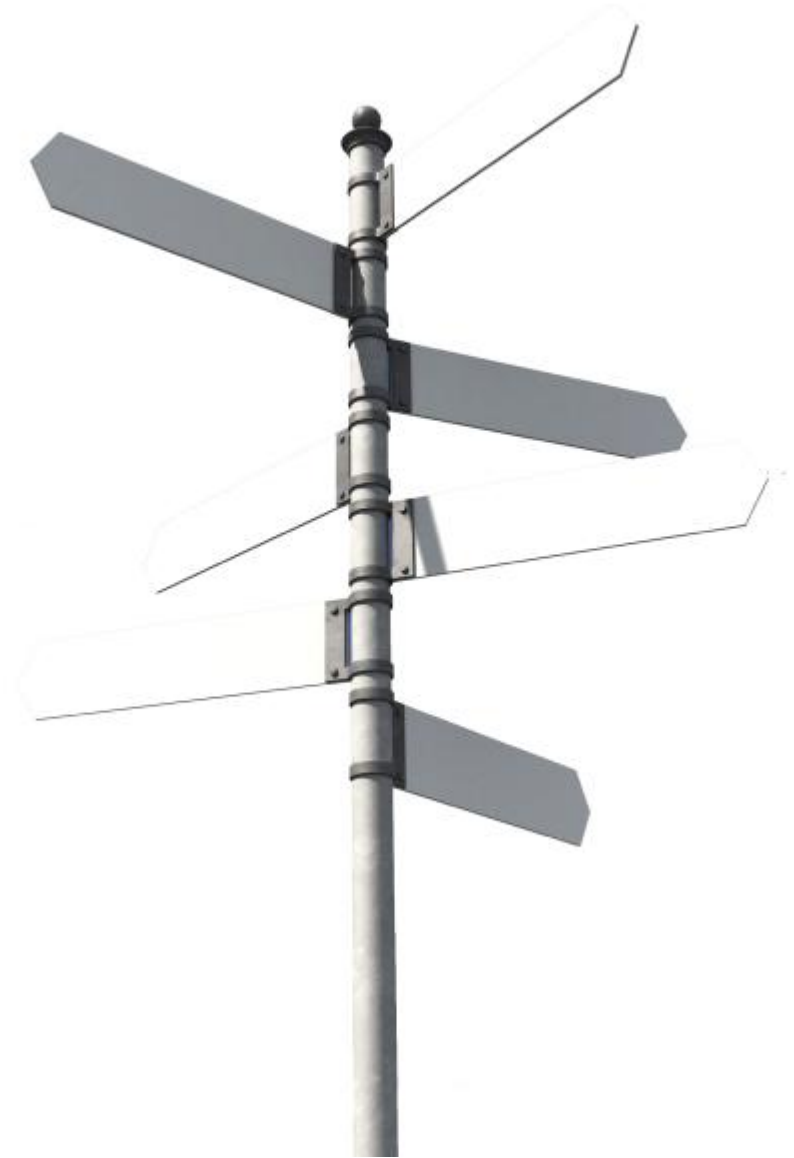
Class A, B+ and B- market balance



New office supply will outpace demand and will drive the vacancy up to 25% by the end of 2010.

Source: Jones Lang LaSalle

Market Response



Key Issues

- The response is underway
- Landlords offering various options:
 1. Shell and Core
 2. Shell and Core with contribution
 3. Partial Fit-Out
 4. Full Fit-Out
- Ultimately the approach should depend on the target audience - Know your clients/buildings
- Rents will reflect fitted-out vs. non fitted-out space
- Revised rents, scarcity of work and drive to lower cap ex has impacted on fit-out costs
- A holistic approach should be adopted by both client and developer to eliminate waste

Conclusions

- At the end of Q1 2009 modern office stock in Moscow reached 11 mn sq m. However, it remains considerably smaller than in other major European capitals
- The Moscow office market is currently one of the most rapidly developing in Europe, with the total pipeline stock of 4.4 mn sq m. Q1 completions set a new record at 1 mn sq m
- Q1 2009 take-up equaled 354,640 sq m (38% lower than in Q1 2008)
- Significant volume of completions entering the market against weakening demand raised the vacancy rate to 17%
- In Q1 2009 Moscow prime rental level showed a 29% decrease. Nevertheless, Moscow held its second place after London in terms of prime rental level (1,000 USD/sq m/year)
- In 2009 we expect a large volume of completions, a fall in take-up, resulting in high vacancy rate and declining office rents and fit-out costs



Thank you


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Legal implications of a new office fit-out in a crisis

Olga Popel
Attorney-at-law

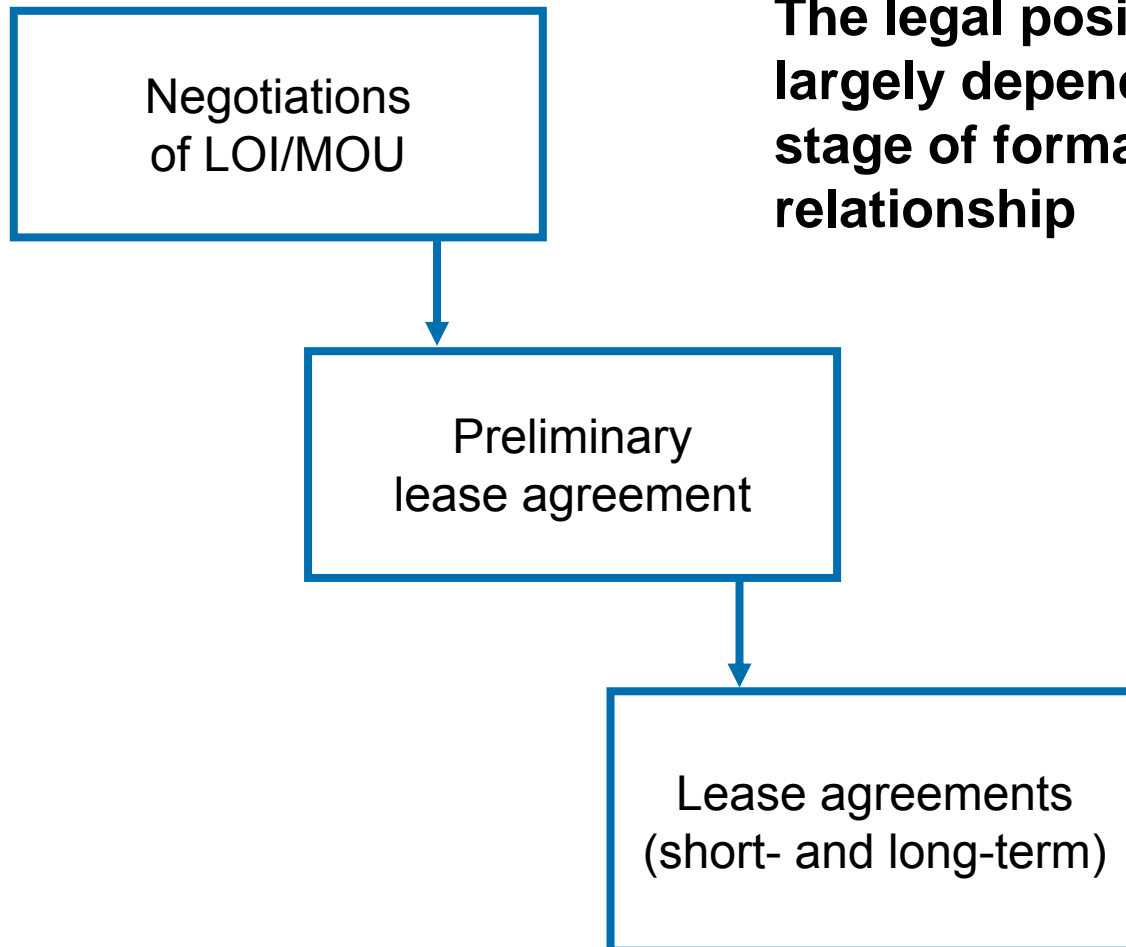
Moscow, May 28th, 2009
AEB Real Estate Committee
Current cost of an office fit-out in a downturn

- 
- ◆ Current trends
 - ◆ Starting scenarios
 - ◆ Legal position of the parties
 - ◆ Security deposit, Rent
 - ◆ Acceptance of the premises
 - ◆ Responsibility

Current trends

- ◆ Termination of preliminary lease agreements / lease agreements
- ◆ Rent discount
- ◆ Refusal to move into leased premises
- ◆ Reduction of leased area
- ◆ Shortened lease terms
- ◆ Growth of secondary market (subletting)

Starting scenarios



The legal position of the parties largely depends on the stage of formalization of their relationship

Legal position of the parties

Thorough review of existing agreements (by both landlords and tenants):

- ◆ Validity of the lease agreement. Duration
- ◆ Security deposit, Rent
- ◆ Access to the premises. Fit-out. Reimbursement
- ◆ Transfer and acceptance procedure
- ◆ Consequences of breach of the lease agreement
- ◆ Possibility of unilateral termination (in court / out of court)
- ◆ Liability of the parties

Security deposit. Rent

Security deposit:

- ◆ Payment securing obligations
- ◆ Condition for granting access to and/or transfer of premises

Rent:

- ◆ Payable upon signing of the lease agreement and
- ◆ Signing of the transfer and acceptance act (if this is not otherwise provided for by a contract)

Acceptance of Premises

◆ Transfer for Fit-Out:

- ◆ Access to the Premises Act (description of technical condition of the premises)
- ◆ Terms and conditions of Fit-Out
- ◆ Approval of a project. Consent of the landlord
- ◆ Utility and maintenance costs. Burden of maintenance
- ◆ Acceptance of Fit-Out

◆ Transfer for Lease

- ◆ Transfer and Acceptance Act (description of technical conditions of the premises; relevant documents)

Responsibility (1)

- ◆ Failure to grant access to the premises for Fit-Out
 - ◆ penalties
 - ◆ adequate extension
 - ◆ termination clauses
 - ◆ compensation for losses
- ◆ Failure to transfer the premises for Lease
 - ◆ penalties
 - ◆ termination clauses
 - ◆ compensation for losses
 - ◆ tenant's right to demand property from the landlord

Responsibility (2)

- ◆ Defects of the premises (latent or unknown to the tenant, wholly or partially obstructing use):

Tenant's rights:

- ◆ to demand elimination or to reduce rent or to demand compensation for expenses
 - ◆ to withhold the expenses from the rent
 - ◆ to terminate, etc.
- ◆ Worsening the conditions of use or state of the Premises
 - ◆ Tenant's right to demand rent reduction

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**Thank you
for your attention.**



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Tax implications of a new office fit-out in crisis

Anna Zvereva
of Counsel, Salans

28 May 2009

Termination of the lease agreement: some tax aspects of the fit-out works earlier performed by the lessee

- ◆ value of the works which have not been depreciated by the date of lease termination
- ◆ transfer of inseparable improvements to the lessor on the termination of the lease agreement: does VATable event arise?

Fit-out works performed by the lessee in the newly leased premises: profit tax aspects

- ◆ Fit-out works at the newly lease premises: repair or capital improvements?
- ◆ Depreciation of the capital improvements by the lessee: potential problems

Fit-out works performed by the lessee in the newly leased premises: some VAT issues

- ◆ when the completed improvements are deemed to have been transferred to the lessor?
- ◆ VAT on the fit-out works payable by the lessee – some recovery issues.

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Cost, Program and Quality - Achieving Goals in Times of Crisis



Summary

- Cost Trends in Moscow Office Fit-out
- Types of Space Available
- Trends

Key Cost Trends

a) Materials

Sample Key Fit-out Construction Materials	Unit	Price per Unit Percent Increase in 2009 as Compared to 2008	Price per Unit Percent Increase in 2009 – January to April
Raised floor - Mero 5GBB30	m2	26.0%	4.0%
Carpet tile - Tarkett Tescom 3680	m2	28.0%	3.0%
Cement	50 kg	3.8%	2.5%
Ceramic tile - Vitra Architek	m2	26.0%	4.8%
Double layers gypsum board partitions with insulation	m2	12.8%	2.5%
Aluminium framed double glazed partitions - Nayada Standart	m2	22.0%	5.4%
Double leaf glass door - Nayada	pc	21.8%	4.5%
Suspended ceiling - Armstrong Prima Dune Plus Board 600x600	m2	20.1%	3.2%
Lights Lighting Technologies - ARS/S 418	pc	32.0%	5.2%
Floor boxes - Mosaic 8M 89300	pc	15.0%	3.2%
Average Increase		20.8%	3.8%

Key Cost Trends

b) Labour

General Contractor Fit-out Works Description	Unit	Price per Unit Percent Increase in 2008 as Compared to 2009	Price per Unit Percent Increase in 2009 – January to April
Installation of raised floor	m2	2.5%	2.5%
Installation of carpet tiles	m2	-6.9%	1.5%
Installation of ceramic tiles	m2	-7.0%	0.8%
Installation of double layer gypsum board partitions with insulation	m2	-15.0%	0.5%
Installation of glazed partitions	m2	13.0%	0.8%
Surface preparation and painting	m2	11.2%	1.5%
Installation of suspended ceiling	m2	-7.8%	1.5%
Installation of lighting fixtures	pc	-11.0%	2.2%
Installation of floor boxes	pc	-5.9%	2.4%
Installation of sockets	pc	-7.6%	2.5%
Average Increase		-3.5%	1.6%

Key Cost Trends

c) Design

Architects	Unit	Price per Unit Percent Increase in 2008 as Compared to 2009	Price per Unit Percent Increase in 2009 – January to April
Local Architect 1	m2	22.20%	3.20%
Local Architect 2	m2	18.05%	3.00%
Local Architect 3	m2	14.40%	3.50%
Average Increase		18.20%	3.20%

Design Engineers	Unit	Price per Unit Percent Increase in 2008 as Compared to 2009	Price per Unit Percent Increase in 2009 January to April
Local Engineer 1	m2	35.70%	4.20%
Local Engineer 2	m2	31.10%	4.10%
Local Engineer 3	m2	31.90%	2.80%
Average Increase		32.90%	3.70%

Overall Key Cost Trends

Moscow wage inflation	-	13%
Construction labour	-	-3.5%
Moscow average fit-out inflation rate	-	15.3%
Average Class A fit-out is now \$900/m ²		

Types of Space

- **Shell and Core**

- Design to suit
- Little hidden costs
- Complete Flexibility
- All systems will be new and with warranty
- No systems or services installed
- Complete fit-out required from systems and services to walls, floors, ceilings and finishes, power, cabling.

Types of Space

- **Advanced Shell and Core**
 - Landlord pre-installed systems
 - Full flexibility for design of space
 - Installed systems may not meet requirements and have to be re-installed to suit
 - Costs to landlord for taking over installed systems

Types of Space

- **Fitted Out Space**

- Less work to move
- Base systems and services may be retained
- Minimal re-fit cost
- Systems and services will not be new and not be covered by warranty
- Space may not suit needs
- Potential greater hidden costs
- Potential greater maintenance and service costs

Trends

- Negotiation at contract time

Landlords, Contractors and Consultants are more flexible.

- Discounts
- Packets of services included
- Advance Payment terms
- Preliminaries
- Profit margins lower

The Six Must-Dos

1. Do define your priorities ahead of time
2. Do technical due diligence! Know what you're getting!
3. Do define and sign a technical appendix to the lease agreement
4. Do, if time allows, separate design and construction to increase price certainty
5. Do appoint a project manager - either in-house or a dedicated company. Check them out beforehand!
6. Do insist upon a fixed price, FIDIC-type, construction specific contract

Thanks for listening...



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How to minimize tenants' expenses

Pavel Barbashev
Development Director
Horus

Landlord's solutions to minimize tenants' office costs

1. Fit-out by landlord:
 - ☐ Fit-out on speculative basis
 - ☐ Fit-out on client basis
2. Campus style projects which provide opportunities to save on office costs



1. Approach to fit-out of vacant space.

Case Study – Burevestnik



Case Study – Burevestnik



Fit-out by Landlord on speculative basis

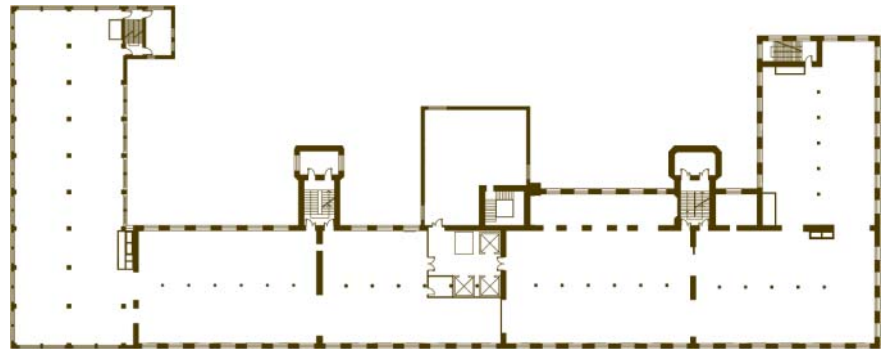


Fit-out by Landlord on speculative basis



Problem:

- ☐ Large open space floor in Shell&Core
- ☐ No demand for such space
- ☐ High vacancy

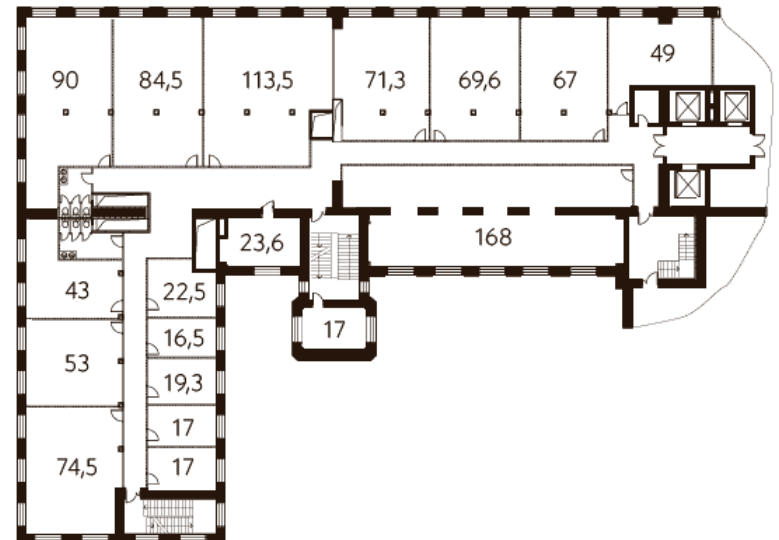
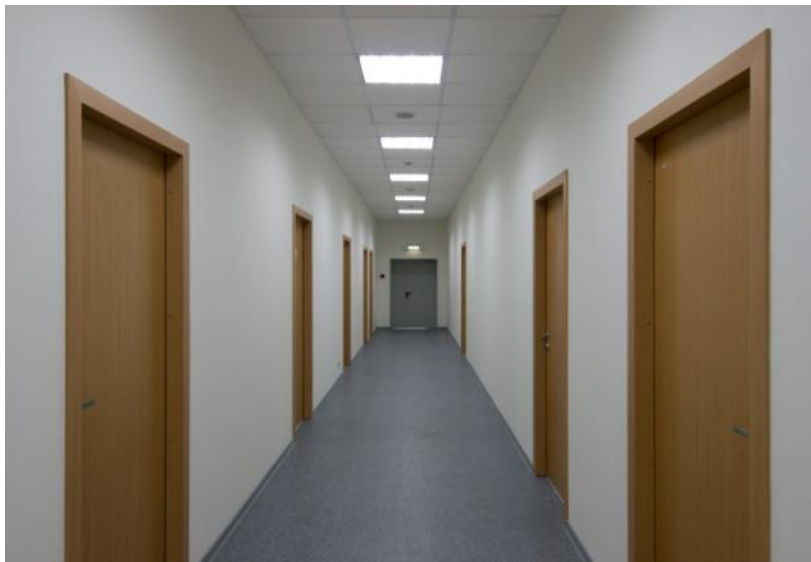


Fit-out by Landlord on speculative basis



Solution:

- ☐ Office blocks from 17 to 500 sq.m.
- ☐ Standard fit-out (“Armstrong” ceiling, gypsum wall, carpet)
- ☐ Opportunity to add HVAC at low cost (connection points available to each office block)
- ☐ Common WCs and server room
- ☐ Short-term leases
- ☐ Ruble fixed rental rates



Fit-out by Landlord on speculative basis



Advantages for tenants:

- ☐ Low rental rate
- ☐ Flexible lease term
- ☐ Quality amenities and property management
- ☐ Effective temporary solution while long-term strategy is out of question



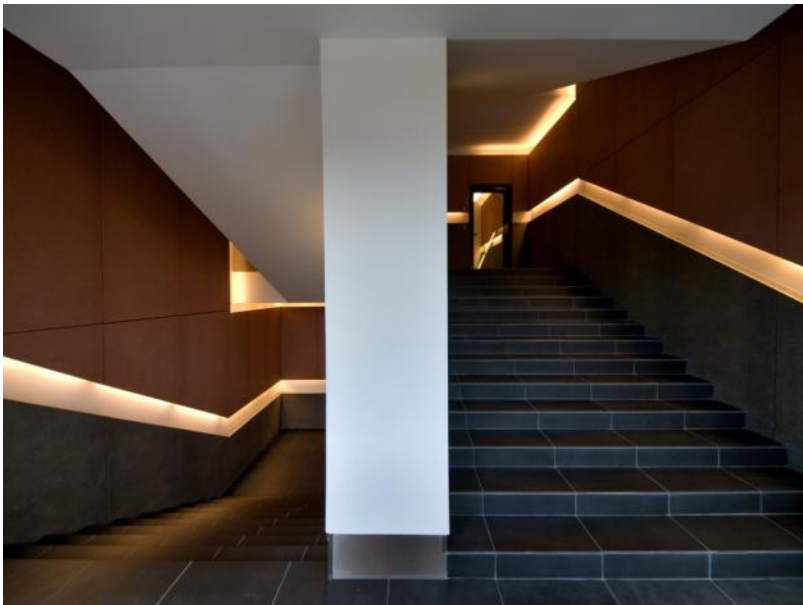
Fit-out by Landlord on client basis



Fit-out by Landlord on client basis



- ☐ Project management by landlord
- ☐ Quality fit-out (\$500-800/sq.m.)
- ☐ Payment for fit-out through advance rent payment (tax-effective approach)
- ☐ Aggressive timing (10 000 sq.m. in less than 4 months)
- ☐ Unique opportunity on the market due to availability of construction resources and reduced construction cost.



Fit-out by Landlord on client basis



2. Advantages of campus style projects.

Case Study – LeFORT
(latest 4 500 sq.m. deal)



Case study – LeFORT

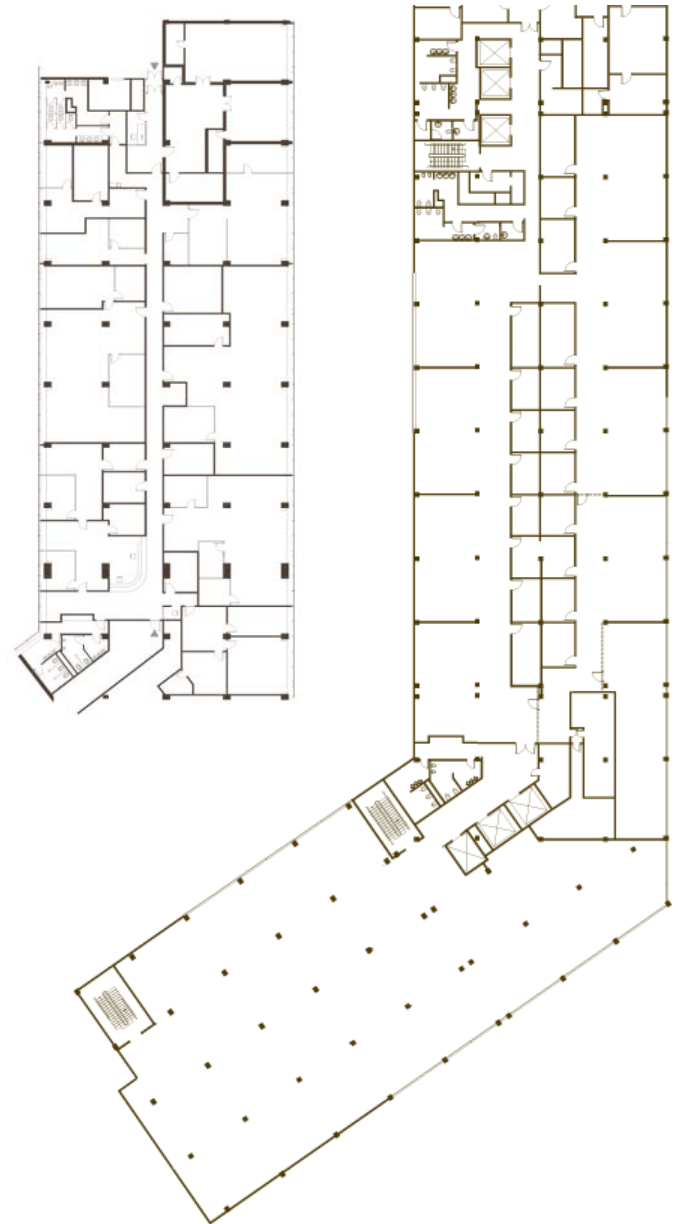


2. Advantages of campus-style projects

- Case study: office 4560 sq.m., leased in April 2009 (3rd and 4th floors of building 8 at LeFORT)

Why the tenant has chosen LeFORT:

- Effective floor plates (6x6 column grid, 24m building depth, 2 elevator lobbies, etc.). As a result the tenant leased 4,500 sq.m. instead of 6,500 currently occupied without any personnel reduction (30% more efficiency)
- High ceilings and perimeter glazing (comfortable workspace)
- Ample parking (1:70) and amenities (2 cantinas, restaurant, bakery, Gold's Gym, ATMs, tour agency, dry cleaning, press point, etc.). All this makes work process more comfortable and therefore, more effective, comparing to working in centrally located buildings
- Independent gas-heating plant station provides year-round hot water and heating without interruption
- Overall savings: approximately 55-60% from current office cost (\$3m per year instead of \$7m)



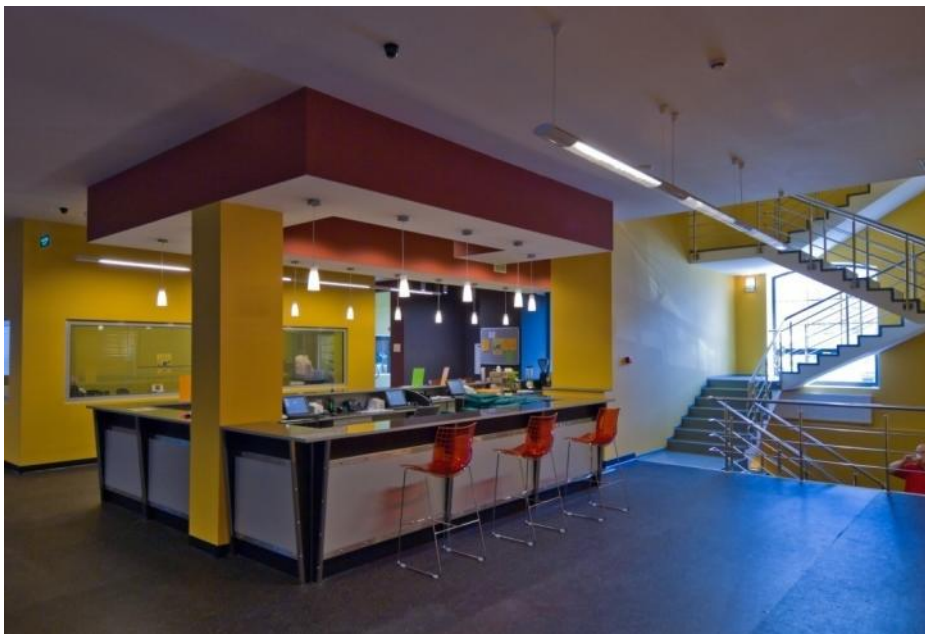
2. Advantages of campus-style projects

Effective floor plates



2. Advantages of campus-style projects

Amenities: Gym



2. Advantages of campus-style projects

Amenities: Cantinas



2. Advantages of campus-style projects

Amenities: Bakery



Amenities: FM



Ample Parking



Conclusion

Current market conditions provide tenants with unique opportunities:

1. Save up to 60% of office costs per employee without reduction in quality
2. Improve quality of your office at same cost or even with 30% savings.

