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REAL ESTATE MONITOR

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CAPITAL · OFFICE · RETAIL · WAREHOUSE · HOSPITALITY · HOUSING



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Frank Schauff

Chief Executive Officer,
Association of European
Businesses

Dear reader,

The AEB Real Estate Committee keeps up-to-date with the situation in the Russian real estate market and provides you with in-depth information about all significant developments. Focusing on Moscow and St. Petersburg, this issue will cover the retail, industrial, office markets in terms of rates and yields, and will acquaint you with the latest trends and tendencies.

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

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

On this note, I wish each and every one of you a Merry Christmas and a prosperous New Year!

**Filippo Baldisserotto**

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

Dear readers,

Soon it will be time to compile the results for 2016, and compare the forecasts to the facts on the ground. So far we have seen a stagnation in real estate proceeds, but the market is still active.

Real estate players have shown their intrinsic capability to adapt to the situation and turn the negative markets trends into the new normal, demonstrating how real talent can overturn poor odds. The market has seen price level changes, new construction volumes and varying approaches to changing consumer behavior. In any case we are glad to see that our sector is moving forward and getting stronger during these times of change.

The Real Estate Committee will hold a couple more events this year and it will be our pleasure to welcome our members and all those who are interested in attending or actively contributing.

We wish all of you a Merry Christmas and prosperous New Year, and confirm the Real Estate Committee's intention to make the upcoming year even more informative and interesting.

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

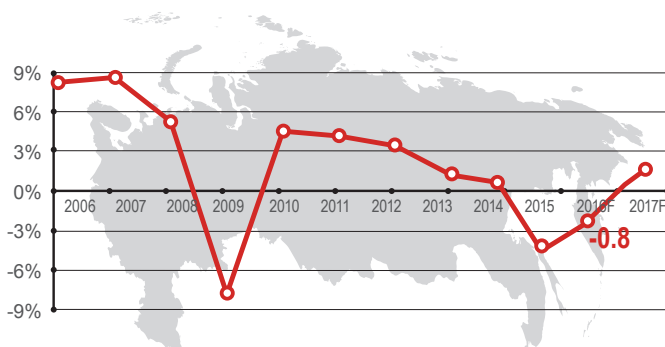
Moscow market overview

Capital market, Q3 2016

- The Russian economy showed signs of improvement. The rouble remained relatively stable, with a slight appreciation bias; oil prices recovered; financial markets posted gains; inflation slowed down. These changes create the basis for the economy to enter the growth phase in the next few quarters.
- High levels of activity were also recorded in the real estate investment sector. In Q1–Q3 2016, real estate investment in Russia increased by 76% YoY and reached USD 3 billion.
- Prime yields remained unchanged in Q3 2016 at 10.5% and 10.75% for Moscow offices and shopping centres respectively, and 12.0% for warehouses.
- Investors were more active in the office segment, and this accounted for 63% of the total investment in Q1–Q3 2016.

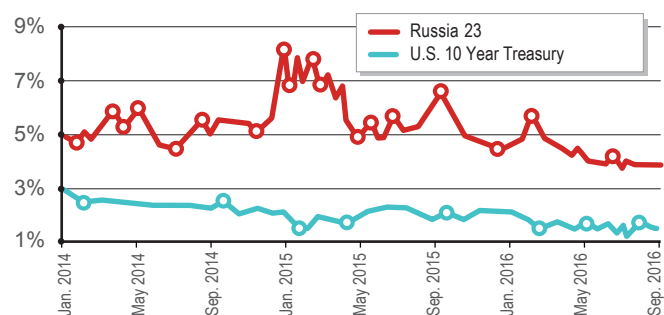
- Investors continued to focus on assets in Moscow, where 88% of all deals were closed in Q1–Q3 2016 and 94% in Q3 2016. Investments in the St. Petersburg real estate market reached USD 156 million compared to USD 61 million a year ago.
- Russian investors dominated in Q1–Q3 2016; they accounted for 95% of deals in Q1–Q3 2016, which is the highest level for the Russian market.
- We forecast that investment will approach USD 4 billion this year, although we acknowledge that there are downside risks to this forecast. Nevertheless, the pickup in activity and ongoing negotiations on several deals indicate a clear improvement after the subdued 2015. (1–9 ►)

1 ► RUSSIA REAL GDP GROWTH



Source: Rosstat, Oxford Economics

2 ► SOVEREIGN DEBT YIELDS



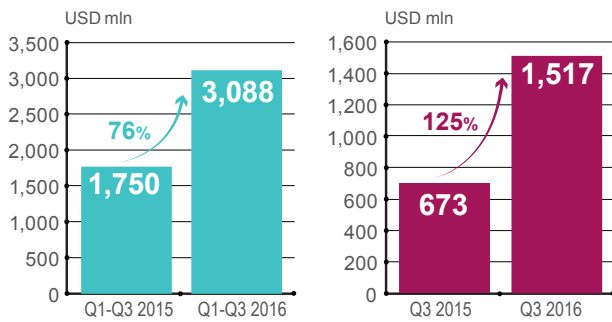
Source: Bloomberg

3 ► EXCHANGE RATE DYNAMICS, RUB/USD



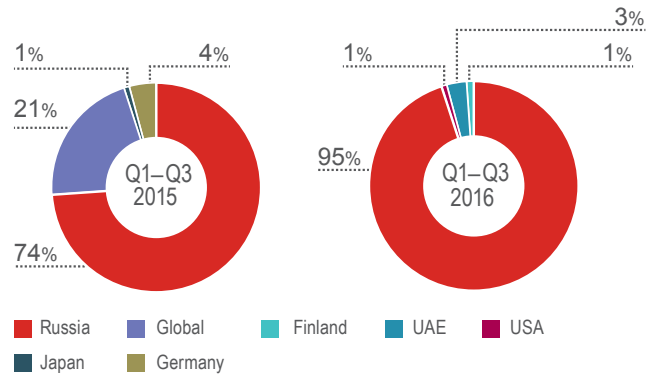
Source: Central Bank of Russia

4 ► RUSSIA INVESTMENT VOLUME DYNAMICS*



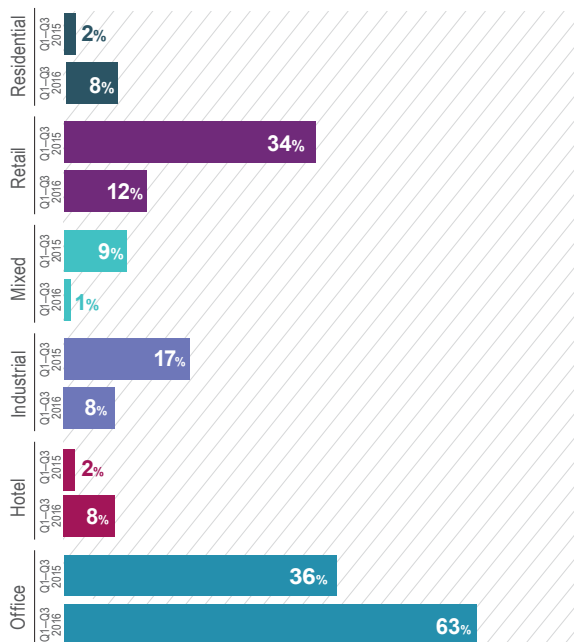
Source: JLL

5 ► INVESTORS BY SOURCE OF CAPITAL



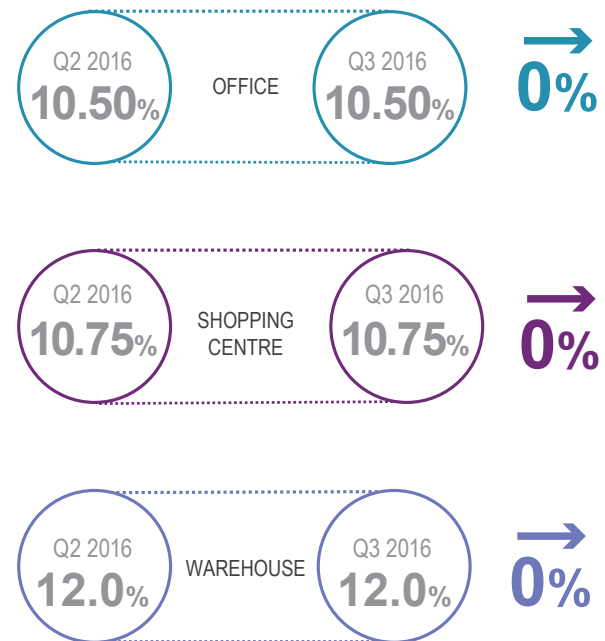
Source: JLL

6 ► INVESTMENT VOLUME BREAKDOWN BY SECTOR



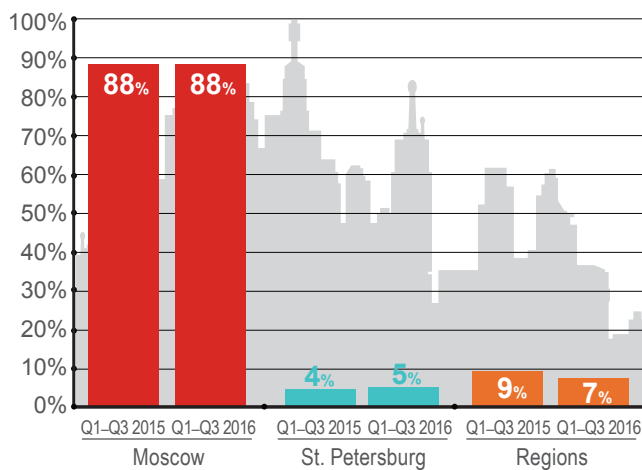
Source: JLL

7 ► PRIME YIELD DYNAMICS IN MOSCOW



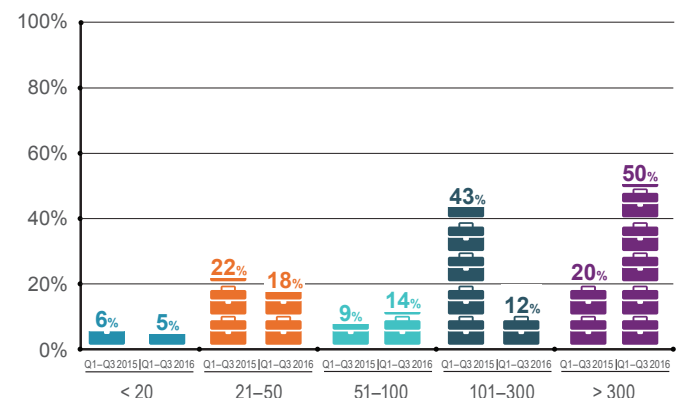
Source: JLL

8 ► INVESTMENT VOLUME BREAKDOWN BY REGION



Source: JLL

9 ► INVESTMENTS BY DEAL SIZE (VOLUME)



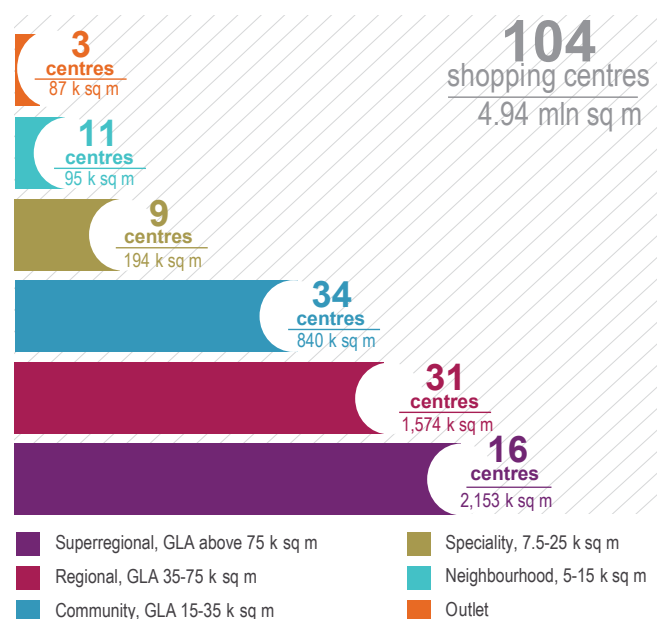
Source: JLL

Retail market, Q3 2016

- In Q3 2016, 190,200 sq m* of new shopping centre space was delivered in Moscow, which is four times higher than in Q3 2015. Okeaniya (60,000 sq m), Khorosho! (53,000 sq m), Kosino Park (39,000 sq m) and the second phase of Metropolis (38,200 sq m) were completed.
- Still, 9M completions dropped by 4% YoY. For the full year, we anticipate an 11% drop compared to 2015 with 500,650 sq m being delivered to the market. New construction will likely continue to decelerate. We expect around 300,400 sq m of new quality shopping centres to be completed in 2017, 40% lower than the 2016 forecast.

- The overall vacancy rate increased from 8.0% to 8.5% in Q3 2016, which is due to the high volume of new retail space. However, the prime vacancy rate dropped by 0.3% to 0.7%. A rise in vacancy rates is expected to continue, reaching 9% by the end of the year due to some 130,000 sq m of new completions.
- The presence of foreign retailers in the Russian market is growing. According to our calculations, 31 new brands have entered the market over the past 9 months, while one brand has left the market.
- Prime and average rents in shopping centres have largely remained at the same level as in Q2 2016. (10–17 ►)

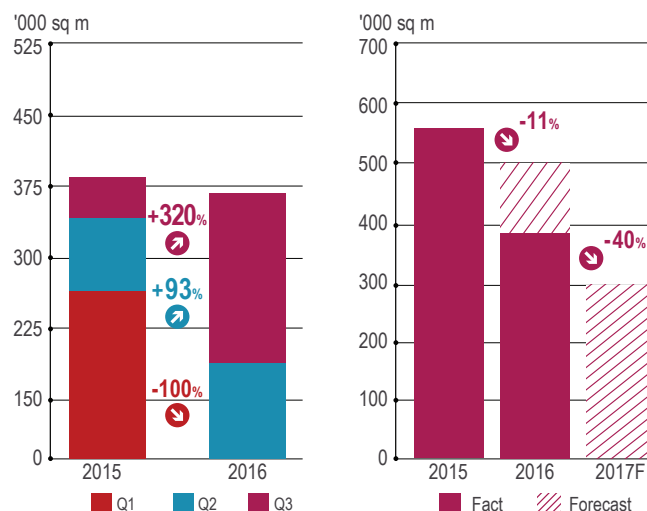
10 ► SHOPPING CENTRE SUPPLY



Source: JLL

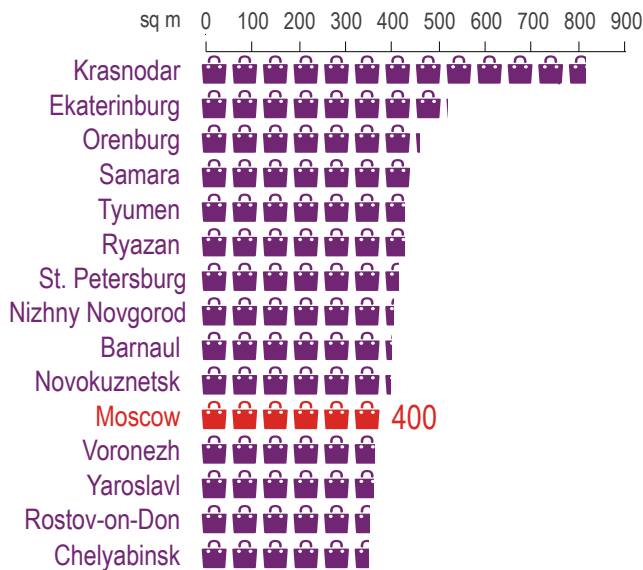
* Hereinafter we use gross leasing areas (GLA).

11 ► SHOPPING CENTRE COMPLETIONS



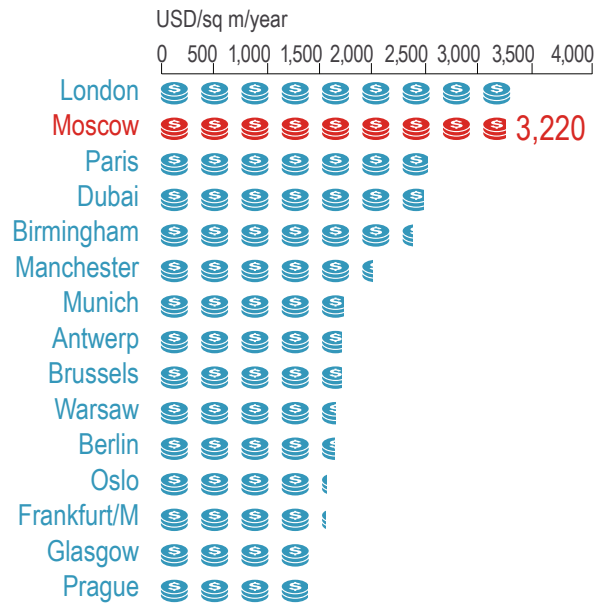
Source: JLL

12 ► STOCK PER 1,000 INHABITANTS IN RUSSIAN CITIES



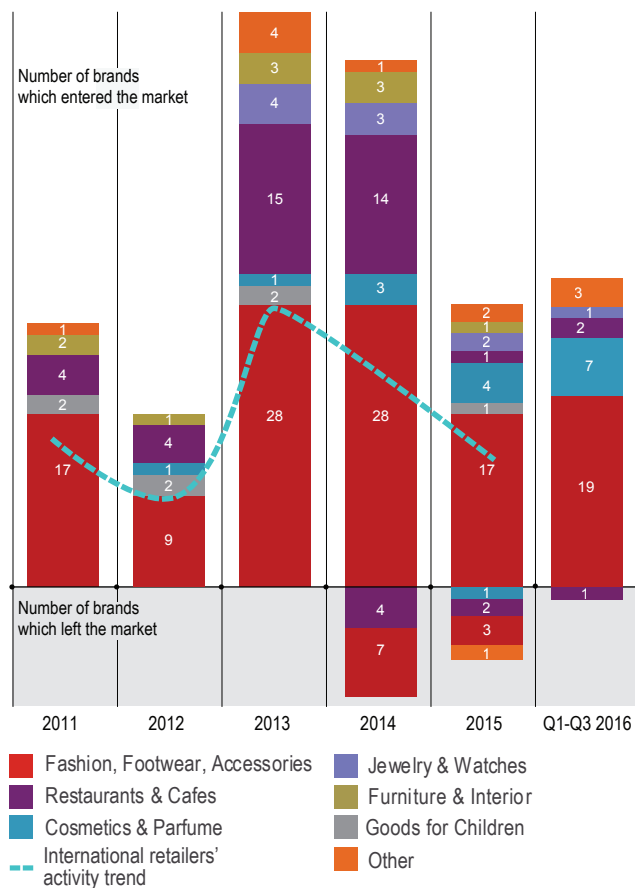
Source: JLL

13 ► PRIME RENT: EUROPEAN COMPARISON



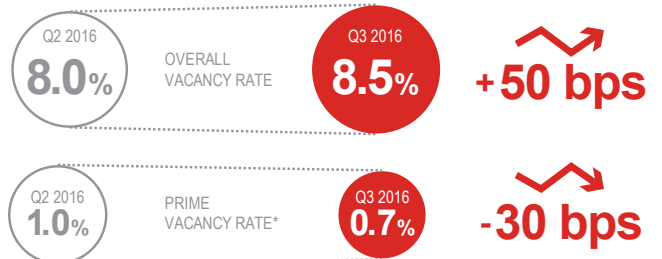
Source: JLL

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



Source: JLL

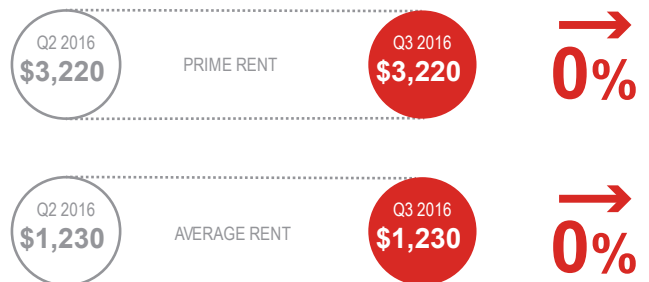
15 ► AVAILABILITY



*based on the basket of the most successful shopping centres with high footfall and conversion rates

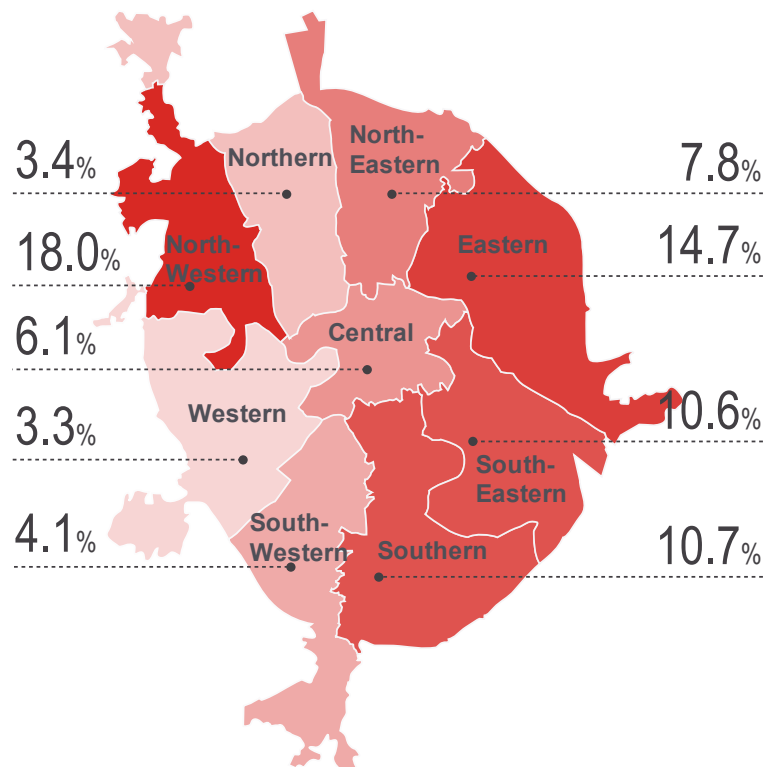
Source: JLL

16 ► PRICING



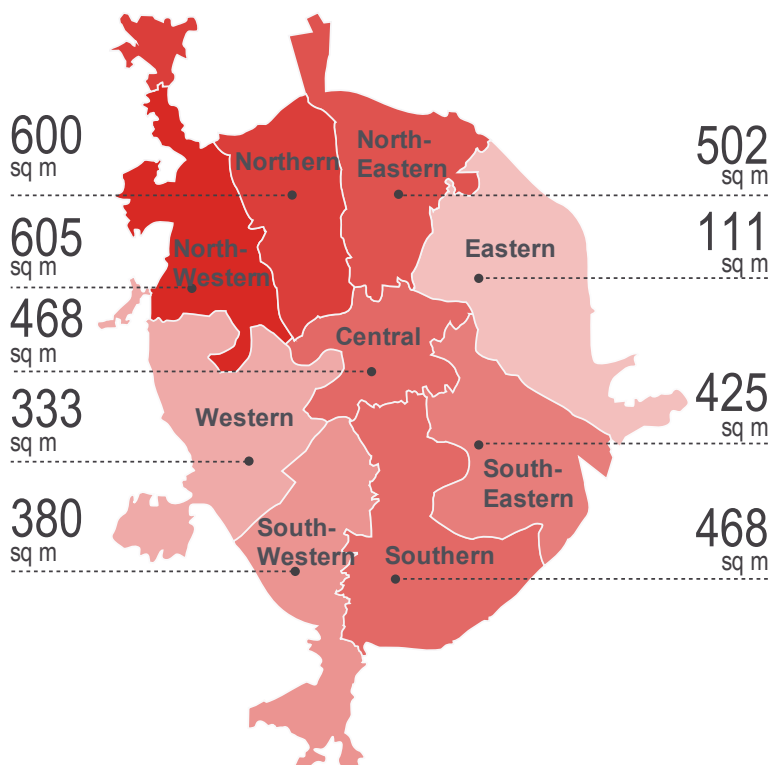
Source: JLL

16 ► VACANCY RATE BREAKDOWN BY MOSCOW DISTRICT



Source: JLL

17 ► SHOPPING CENTRE DENSITY BY MOSCOW DISTRICT (SQ M PER 1,000 INHABITANTS)



Source: JLL

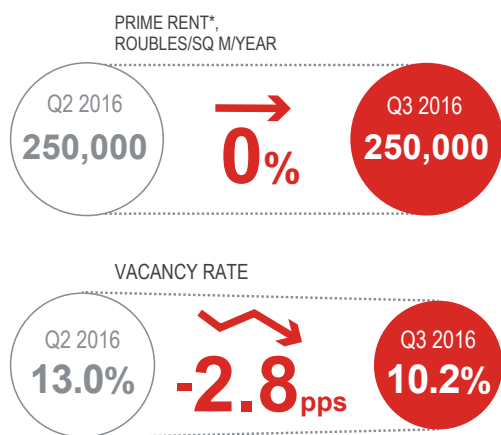
Street-retail market, Q3 2016

- Prime rents for the main retail corridors on the Moscow street retail market remained unchanged in Q3 2016 at 250,000 roubles/sq m per year.
- The vacancy rate on the primary retail corridors declined from 13% to 10.2%. In Q3 2016, Patriarshie Prudy and Myasnitskaya street demonstrated the lowest vacancy rates out of the main Moscow retail corridors; 5.6% and 6.8% respectively. A significant drop in vacancies and marginal rental growth was observed on Novy Arbat street due to the recent reconstruction work.
- On the demand side, restaurants and cafes continue to be the most active (accounting for 44% of leasing inquiries).

Tenants of the "Grocery stores and Supermarkets" segment comprise 13% of the total demand. The third largest group is "Health & Beauty", which accounts for 11% of demand. 100–300 sq m premises were the most in demand (44% of all inquiries).

- Fashion operators continue to focus on well-known central streets such as Kuznetsky Most, Nikolskaya, Bolshaya Dmitrovka and Stolesnikov pereulok. In Q3 2016, the locations with the highest tenant rotation were Bolshaya Dmitrovka (21%) and Kuznetsky Most (21%). The lowest level of rotation (3%) was observed in Myasnitskaya, Nikolskaya and Patriarshie Prudy. (18–23 ▶)

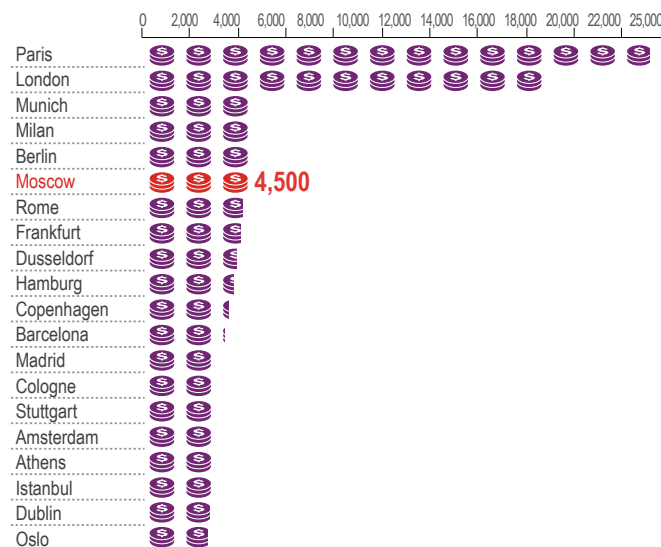
18 ▶ MOSCOW HIGH STREET INDICATORS



*Rents are given for rectangular form premises of 100–300 sq m with a separate entrance and a showcase on the first floor inside the Third Ring Road. For multi-storey buildings and larger premises rents might be revised downwards.

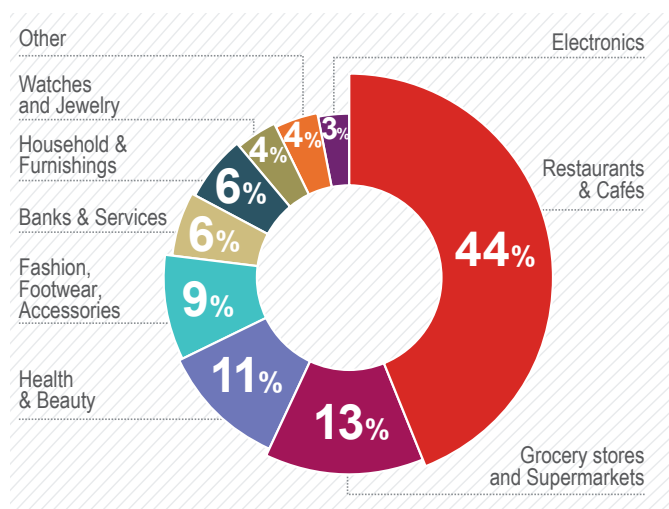
Source: JLL

19 ▶ EUROPEAN PRIME STREET RETAIL RENT INDICATORS



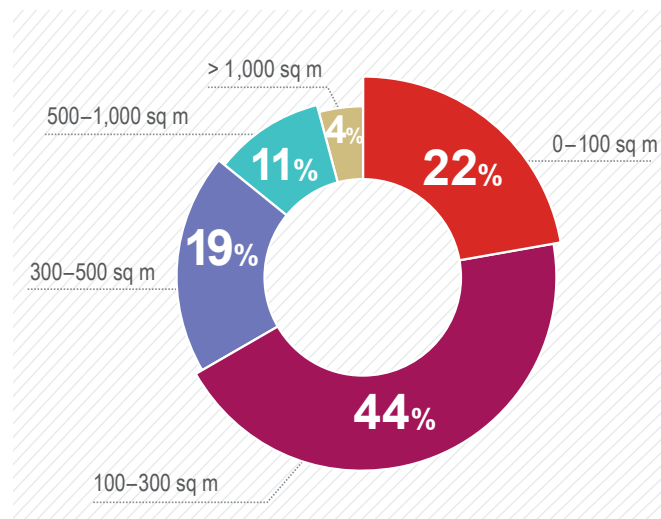
Source: JLL

20 ▶ DEMAND BY RETAILER PROFILE



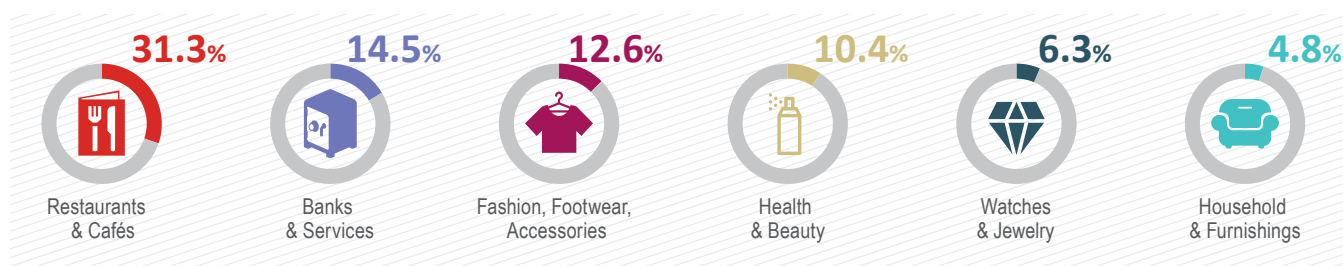
Source: JLL

21 ▶ DEMAND BY SIZE, SQ M



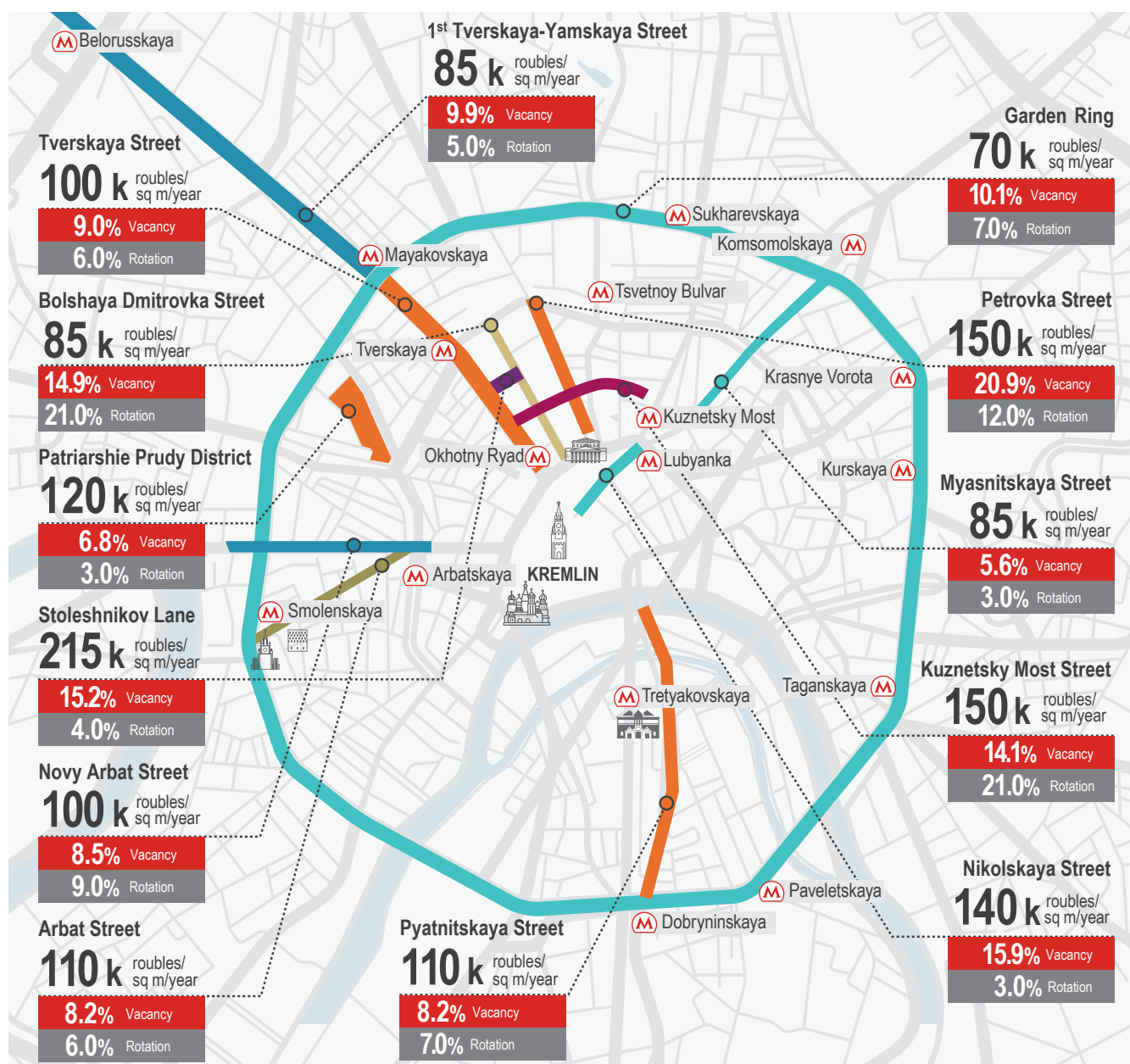
Source: JLL

22 ► BREAKDOWN OF HIGH STREET TENANTS BY PROFILE



Source: JLL

23 ► MOSCOW HIGH STREET RETAIL AVERAGE RENTS* AND VACANCY RATES



*Rents are given for rectangular form premises of 100–300 sq m with a separate entrance and a showcase on the first floor inside the Third Ring Road. For multi storey buildings and larger premises rents might be revised downwards.

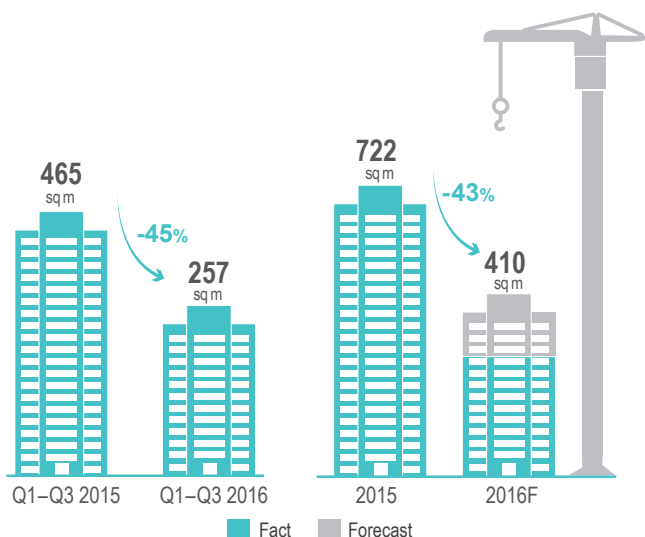
Source: JLL

Office market, Q3 2016

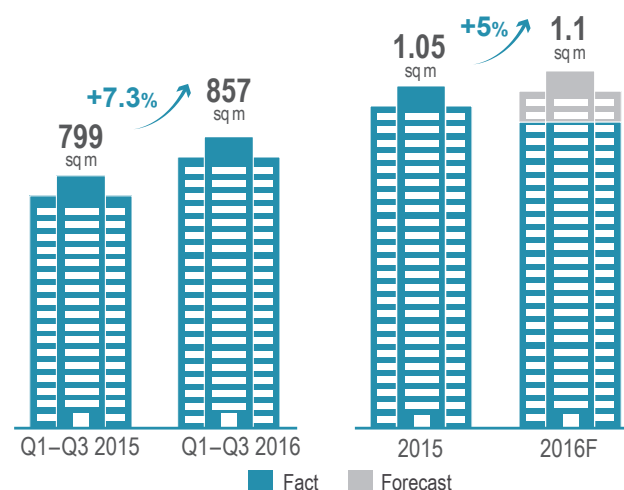
- In Q3 2016, 82,000 sq m of quality office premises were delivered to the market, which was 62% below the level of Q3 2015. In Q1–Q3 2016, about 257,000 sq m were delivered, 45% down YoY.
- With about 153,000 sq m expected in Q4, the total volume of quality office space delivered in 2016 will reach approximately 410,000 sq m (-43% YoY) setting a new low for the decade.
- The office take-up in Moscow in Q1–Q3 showed a 7% YoY increase at 857,000 sq m, whereas the Q3 volume was 279,000 sq m, 9% down YoY.

- The overall vacancy rate in Moscow changed little in Q3, standing at 15.7% compared to 15.6% in Q2 and 15.8% in Q1 2016. The most noticeable changes occurred in Class A where the vacancy rate in Q3 contracted to 20.3% from 26.8% in Q3 2015. Attractive rental terms are encouraging tenants to move to quality premises.
- Asking rents were stable for most segments: USD 400–600/sq m/year for Class A premises and RUB 12,000–20,000/sq m/year for Class B+. A minor correction was registered in the upper limit of the premium segment, where rents now range from USD 600–750/sq m/year. (24–31 ►)

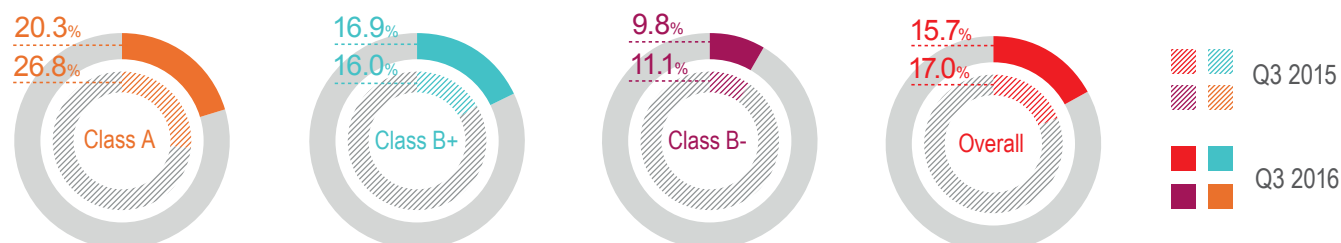
24 ► NEW SUPPLY



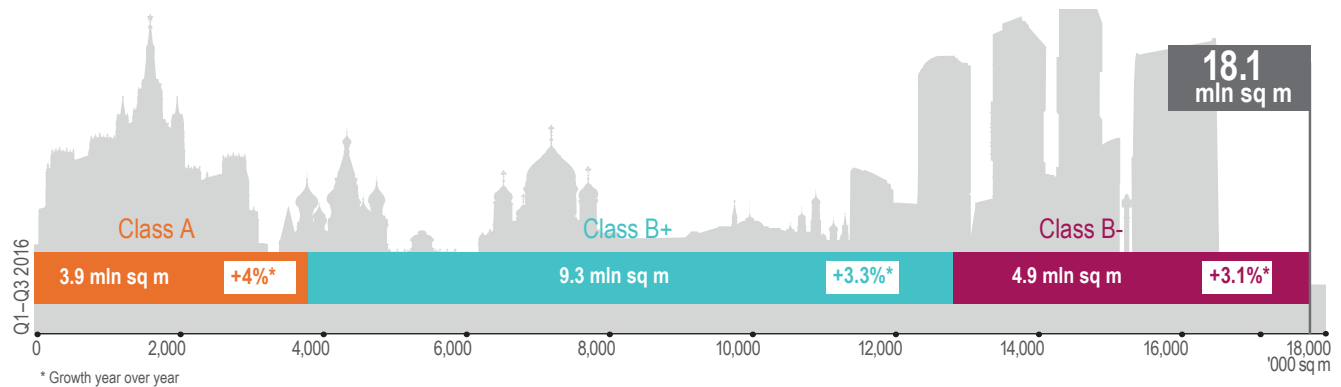
25 ► OFFICE TAKE-UP



26 ► VACANCY RATES BY CLASS



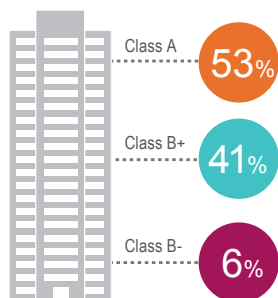
27 ► MOSCOW OFFICE STOCK BY CLASS



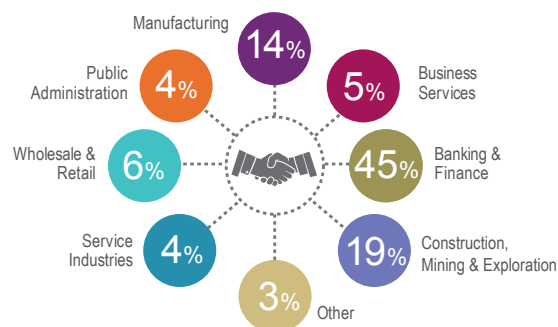
Source: JLL

28 ► TRANSACTED SPACE BY CLASS, SECTOR AND LOCATION, Q1-Q3 2016

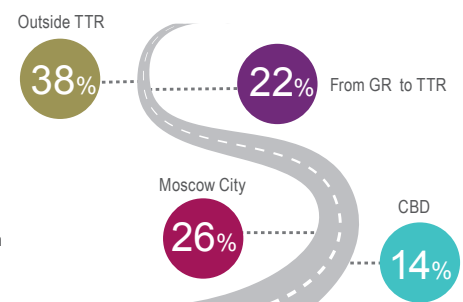
BY CLASS



BY BUSINESS SECTOR

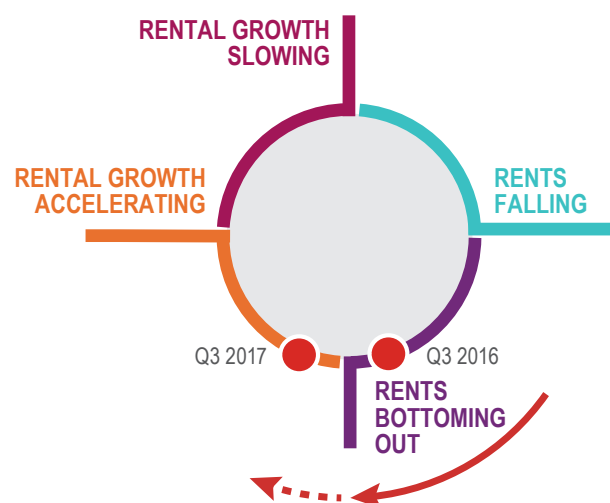


BY SUBMARKET



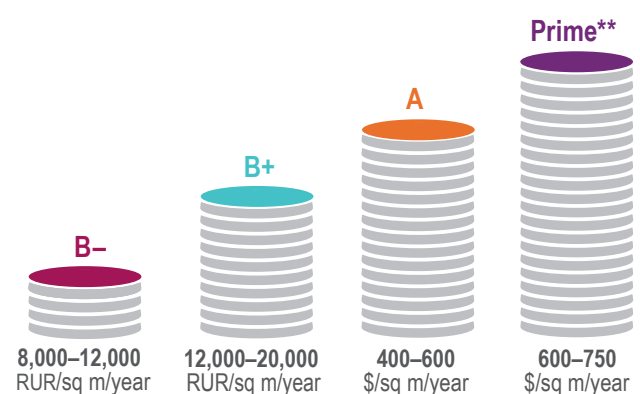
Source: JLL

29 ► OFFICE PROPERTY CYCLE IN MOSCOW



Source: JLL

30 ► 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

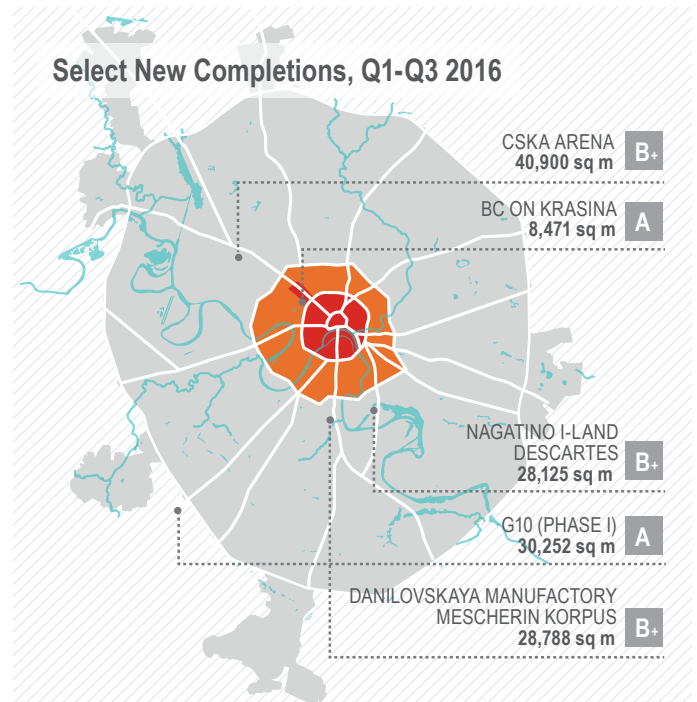
31 ► MOSCOW OFFICE SUBMARKETS, Q1–Q3 2016

	CBD*	MOSCOW CITY	GR TO TTR **	OUTSIDE TTR ***
Stock, sq m	3,953,698	910,785	4,467,296	8,731,859
Availability, sq m	502,583	178,586	505,263	1,645,669
Vacancy Rate, %	12.7	19.6	11.8	18.8
Transacted Space, sq m	50,273	15,781	54,985	157,934

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

** Excludes Moscow City

*** Includes projects outside MKAD



Source: JLL

Warehouse market

TRENDS. MOSCOW REGION

Falling demand for quality warehouses is the main trend in the warehouse real estate segment in 2016.

Demand is typically supported by retail chains, but in Q3 the most significant drop in the size and number of deals was from retailers. At the same time, there has been a slight increase in demand from manufacturing and logistic companies.

With this low demand, rental rate reductions are not helping developers to attract new tenants, so landlords are no longer decreasing asking rental rates. The average A class rental rate remained stable in Q2–Q3 and comprises RUB 3,800–4,000/sq m/year.

In the second half of 2016, construction activity started to slow down in the Moscow region. Therefore, we expect the vacancy rate to decrease by mid-2017, even though the current demand for warehouse space is low. (32, 33 ►)

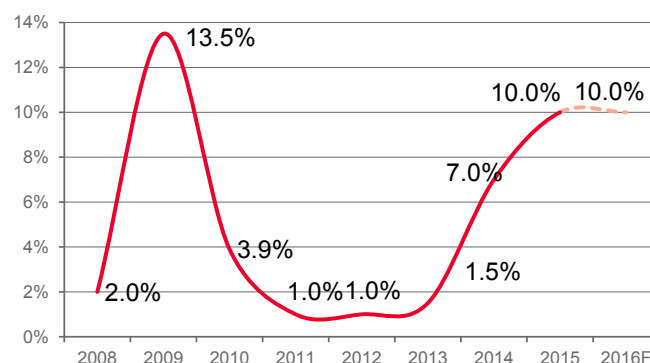
NEW CONSTRUCTION. MOSCOW REGION

330,000 sq m of new quality warehouse space was delivered to the market in Q3 2016. According to developer plans, 851,000 sq m of new space is expected by the end of 2016, which is similar to 2015.

The vacancy rate did not change in Q3 2016 and now comprises 10%. We don't expect any change in the vacancy rate until the end of the year.

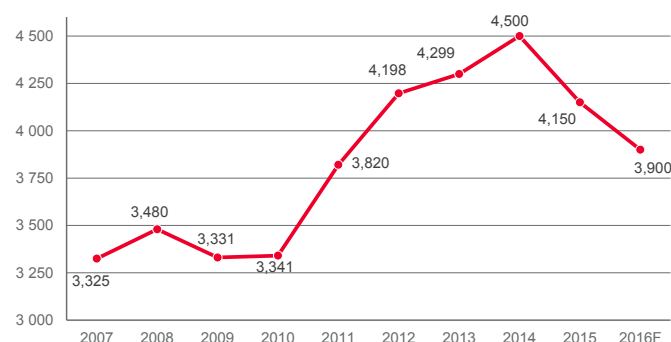
New construction will decrease significantly in 2017. We expect no more than 500–550,000 sq m of new quality warehouse space to be delivered. As a result, the vacancy rate will decrease by the end of 2017. (34 ►)

32 ► VACANCY RATE, CLASS A



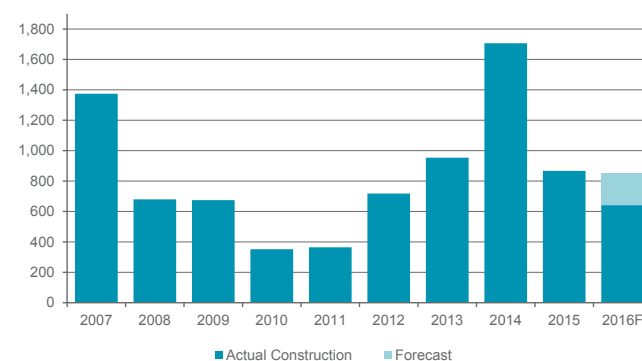
Source: Cushman & Wakefield Research

33 ► NET RENTAL RATE*, CLASS A, (RUB/SQ M/YEAR)



Source: Cushman & Wakefield Research

34 ► NEW CONSTRUCTION, CLASSES A AND B, '000 SQ M



Source: Cushman & Wakefield Research

DEMAND. MOSCOW REGION

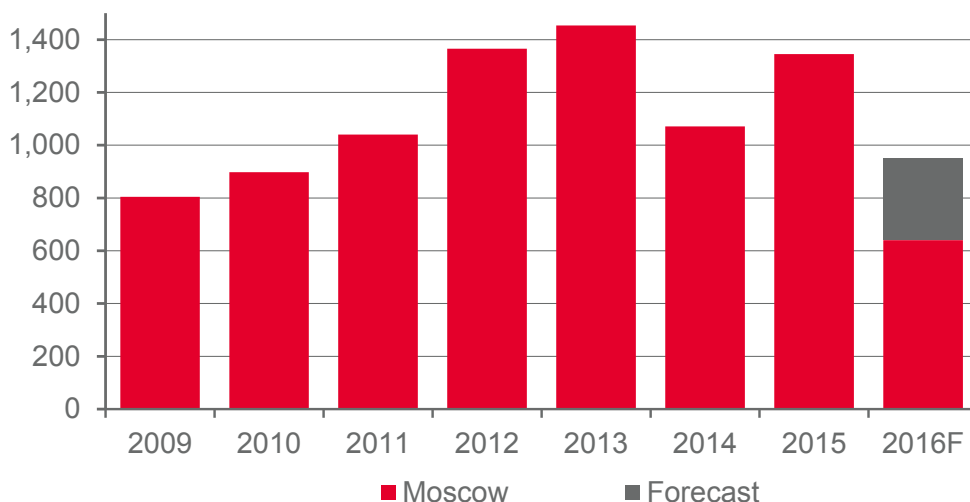
In Q3 2016, the total volume of closed deals in the warehouse segment – both lease and sale – was 245,000 sq m. This is 20% lower than the average volume for 2008–2015.

was half that of Q1–Q3 2015. At the same time there was a 10% growth in activity from the industrial and logistic segments.

The retail segment showed the biggest drop in activity. In Q1–Q3 2016, the number of closed deals in this segment

In Q1–Q3 2016, the average size of closed deals was 40% lower than in Q1–Q3 2015 – 8,500 sq m. **(35 ►)**

35 ► TAKE UP, CLASSES A AND B, '000 SQ M



Source: Cushman & Wakefield Research

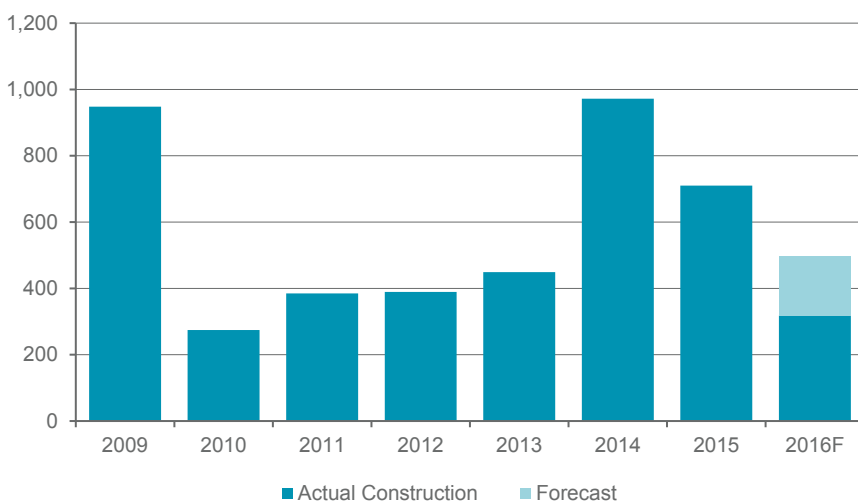
NEW CONSTRUCTION. REGIONS

Construction activity has dropped in the regions in 2016 – 30% less space than last year will be delivered to the market. At the same time, 40% of space completed in 2016 is already under prelease or sales agreements.

The largest share of new warehouse premises will be constructed in St. Petersburg and its region – 151,000 sq m will be delivered to the market in 2016.

We expect the volume of new construction in 2017 to be lower than in 2016. **(36 ►)**

36 ► NEW CONSTRUCTION, CLASSES A AND B, '000 SQ M



Source: Cushman & Wakefield Research

DEMAND. REGIONS

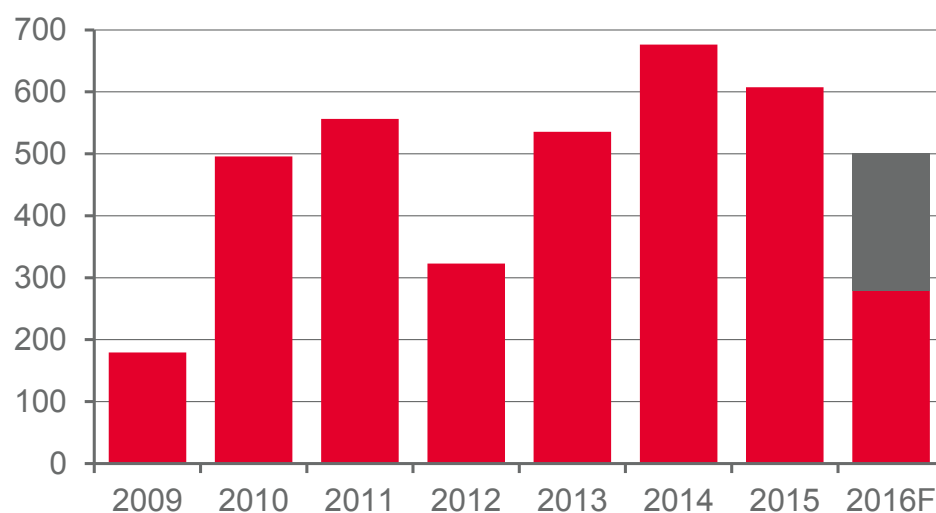
In Q3 2016, the total volume of closed deals in the warehouse segment – both lease and sale – was 75,000 sq m. This is 30% lower than the average take up in 2008–2015.

In Q1–Q3 2016, the average size of closed deals was 25% lower than the average for Q1–Q3 2015 – 7,500 sq m.

In the first 9 months of 2016 there was a drop in tenant activity in all segments except logistics. Compared to the first 9 months of 2015, the most significant drop in activity was in manufacturing (by 3 times) and retail (by 30%).

We expect take up in 2016 to be 17% lower than in 2015, at around 500,000 sq m. (37 ►)

37 ► NEW CONSTRUCTION, CLASSES A AND B



Source: Cushman & Wakefield Research

Hospitality market – Moscow hotels in Q3 2016

The upscale segment continued to demonstrate a positive trend in the rouble ADR (average daily rate) and RevPAR (revenue per available room) compared to Q3 2015, and showed a 10% and 14% increase (RUB 12,183 and RUB 8,426) respectively. US dollar ADR figures fell by 3% and comprised USD 181. The US dollar RevPAR increased by 1% (USD 126) respectively. The overall occupancy rate increased by 2% (69%).

Business hotels showed the following results in January–September 2016. The US dollar RevPAR dropped by 2% (USD 65), which was composed of a 5% occupancy increase (75%) and a 8% fall of the US dollar ADR (USD 86). The rouble RevPAR increased by 11% (RUB 4,337) in line with a 4% ADR rise (RUB 5,826).

A certain drop was observed in the midscale segment. The US dollar ADR and RevPAR dropped by 13% and 7% respectively, amounting to 63 US dollars and 50 US dollars. The rouble ADR decreased by 1% (RUB 4,254) while the RevPAR rose by 6% (RUB 3,353). The only increase was seen in the overall occupancy rate, which rose by 5% (79%).

Average occupancy across all market segments of Moscow hotels grew by 4% (74%) from Q3 2015. During Q3 2016 both the dollar ADR and RevPAR decreased (6% and 2% respectively), amounting to USD 110 and USD 80. At the same time, the rouble ADR increased by 6%, amounting to RUB 7,421 along with the RevPAR which increased by 11% (RUB 5,372).

Comparing the results of Q3 2016 to the previous year when we observed extreme fluctuations of the US dollar against the rouble, we can conclude that these fluctuations are continuing to downshift. The US dollar/rouble exchange rate increased by 13% in January–September 2016 from the corresponding period in 2015.

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

- The variation between the upscale and midscale segments comprised USD 76/RUB 5,073 compared to USD 71/RUB 4,246 in Q3 2015.
- The difference in the RevPAR between upscale and business hotels changed to USD 61/RUB 4,089 compared to the Q3 2015 results (USD 59/RUB 3,516). (38 ►)

38 ► HOTELS OPENED AS OF SEPTEMBER 2016 IN MOSCOW AND THE MOSCOW REGION

Name	Room number	Address	Class
Moscow			
Holiday Inn Seligerskaya	201	10 Korovinskoe Highway	4 stars
Moscow region			
Ibis Stupino	129	42 Pobedy Avenue, Stupino	3 stars
Emerald Wood	6 guest houses	Near the villages of Sharino and Denisovo, Klinsky district	4–5 stars
Total: 3 hotels	330 rooms, 6 guest houses		

Source: EY database, open sources, operator data

Hotels opened in January–September 2016:

- Accor Hotels announced the opening of a new Ibis Stupino hotel in Stupino, Moscow region, in April 2016. The hotel at 42 Pobedy Avenue offers 129 rooms, a restaurant, a bar, two conference halls and two meeting rooms.
- InterContinental Hotels Group announced the opening of Holiday Inn Moscow – Seligerskaya hotel after reconstruction. The hotel located at 10 Korovinskoe Highway was called Iris Congress Hotel before rebranding. The hotel offers 201 rooms, a restaurant, a lounge bar, a

café, 12 conference halls, a concert hall, a fitness center with a swimming pool and a sauna. The owner of the hotel is Amtel Properties.

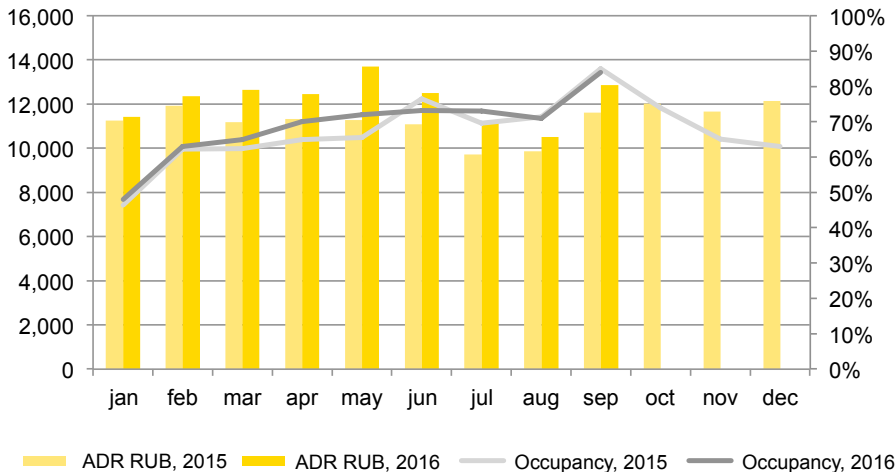
- A new Emerald Wood eco-hotel opened near the villages of Sharino and Denisovo, Klinsky district in the Moscow region at the end of August 2016. The countryside hotel offers six guest houses, a restaurant, a recreational centre with a swimming pool and a SPA, a children's park and a beach.

We expect the following hotels to open in 2016: (39–44 ►)

39 ► FUTURE HOTELS ANNOUNCED FOR OPENING IN MOSCOW IN 2016

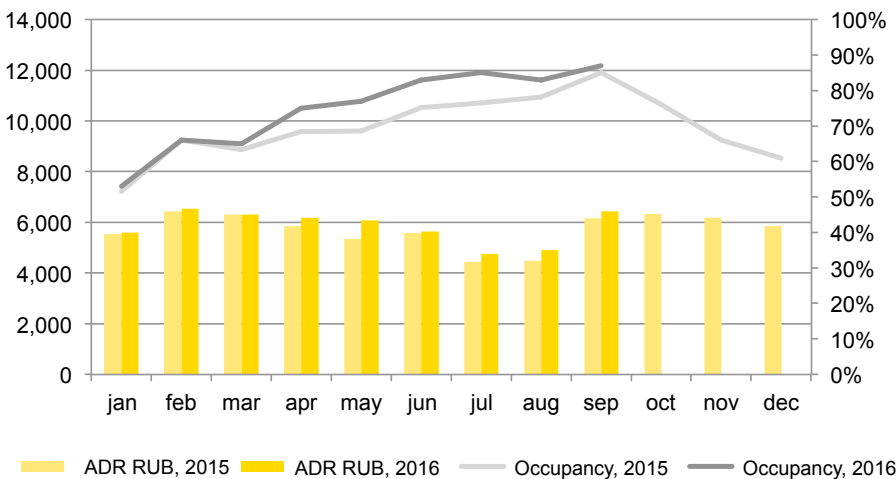
Name	Room number	Address	Class
Moscow			
Novotel Moscow Kievskaya	250	Intersection of Kievskaya street and 2 nd Bryansky Lane	3 stars
Adagio Moscow Kievskaya	150		3 stars
Ibis Moscow Kievskaya	300		3 stars
Hyatt Regency Moscow Petrovsky Park	298	36 Leningradsky Avenue	4 stars
Ibis Moscow Oktyabrskoe Pole	242	2 Marshala Rybalko street	3 stars
Ibis Budget Oktyabrskoe Pole	108		2 stars
DoubleTree by Hilton Vnukovo Airport	432	Vnukovo Airport	4 stars
Total: 7 hotels	1,780		

Source: EY database, open sources, operator data

40 ► 5-STAR HOTELS: ADR* (RUB) AND OCCUPANCY, 2016 VS. 2015

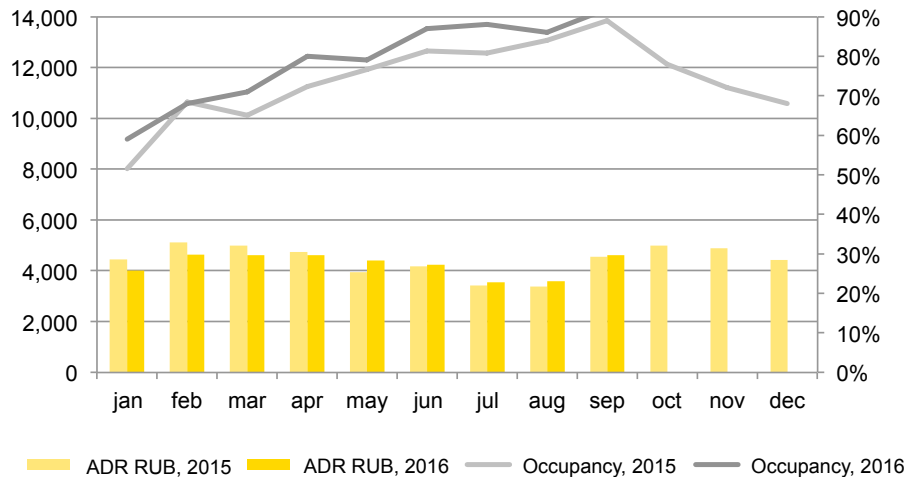
* average daily rate

Source: EY analysis

41 ► 4-STAR HOTELS: ADR* (RUB) AND OCCUPANCY, 2016 VS. 2015

* average daily rate

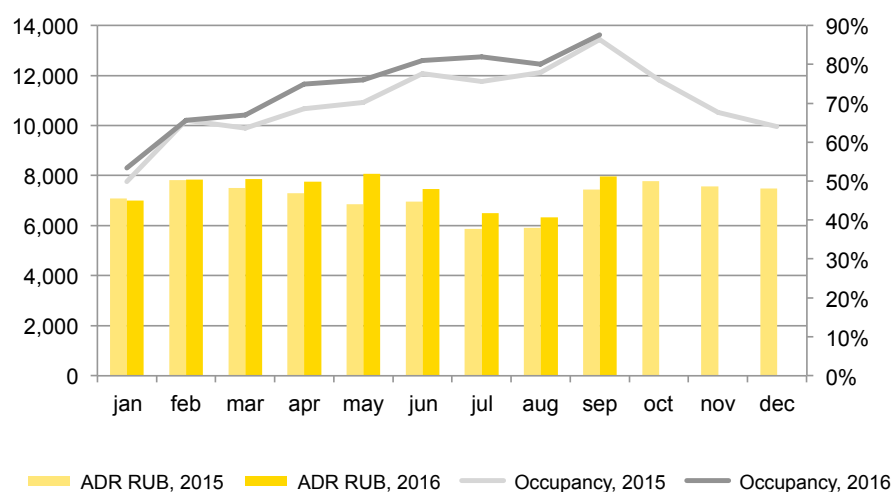
Source: EY analysis

42 ► 3-STAR HOTELS: ADR* (RUB) AND OCCUPANCY, 2016 VS. 2015

* average daily rate

Source: EY analysis

43 ► AVERAGE MARKET ADR* (RUB) AND OCCUPANCY, 2016 VS. 2015



* average daily rate

Source: EY analysis

44 ► OPERATIONAL INDICES

	January–September 2016 (US Dollars/Roubles)	January–September 2015 (US Dollars/Roubles)	January– September 2016/January– September 2015, %	2015
5 stars				
Occupancy	69%	67%	2%	67%
Average daily rate (ADR)	USD 181/RUB 12,183	USD 186/RUB 11,029	-3%/10%	USD 184/RUB 11,258
Revenue per available room (RevPAR)	USD 126/RUB 8,426	USD 125/RUB 7,418	1%/14%	USD 124/RUB 7,578
4 stars				
Occupancy	75%	70%	5%	70%
ADR	USD 86/RUB 5,826	USD 94/RUB 5,576	-8%/4%	USD 93/RUB 5,713
RevPAR	USD 65/RUB 4,337	USD 66/RUB 3,902	-2%/11%	USD 65/RUB 3,962
3 stars				
Occupancy	79%	74%	5%	74%
ADR	USD 63/RUB 4,254	USD 73/RUB 4,307	-13%/-1%	USD 72/RUB 4,423
RevPAR	USD 50/RUB 3,353	USD 54/RUB 3,172	-7%/6%	USD 53/RUB 3,245
Average				
Occupancy	74%	71%	4%	70%
ADR	USD 110/RUB 7,421	USD 118/RUB 6,971	-6%/6%	USD 116/RUB 7,131
RevPAR	USD 80/RUB 5,372	USD 82/RUB 4,831	-2%/11%	USD 81/RUB 4,928

Source: Smith Travel Research, EY analysis

Moscow housing market

After April of this year rental rates reached their minimum values seen over the last year and a half, but in the past few months, they have gradually risen. This upward trend is also characteristic of demand budgets. For example, in September 2016 the average rental rate requested by prospect tenants was nearly 10% higher than in August. This can be partly attributed to the beginning of the active business season, but, according to our observations, this is still a long-term trend.

SUPPLY

• From the beginning of 2016 the volume of supply of luxury apartments for rent decreased by 18%. However, during the third quarter the rate remained at roughly the same level. Over the last year in 5 of the 14 districts of Moscow, which have high-budget apartments for rent, the volume of supply decreased by an average of more than 20%. This dramatic decline was recorded in areas such as Arbat-Kropotkinskaya (-45%) and Tverskaya-Kremlin (-23%). At the same time the Prospect Mira area saw the largest increase in the number of lots offered for rent (+27% from Q3 last year).

• Arbat-Kropotkinskaya – a traditional area leader in the number of high-budget rental apartments: almost every fifth apartment is represented in this location.

• Leningradsky prospekt has become one of the main centres of business activity in the capital. This area, where there are about 50 business centres, is one of the fastest growing locations.

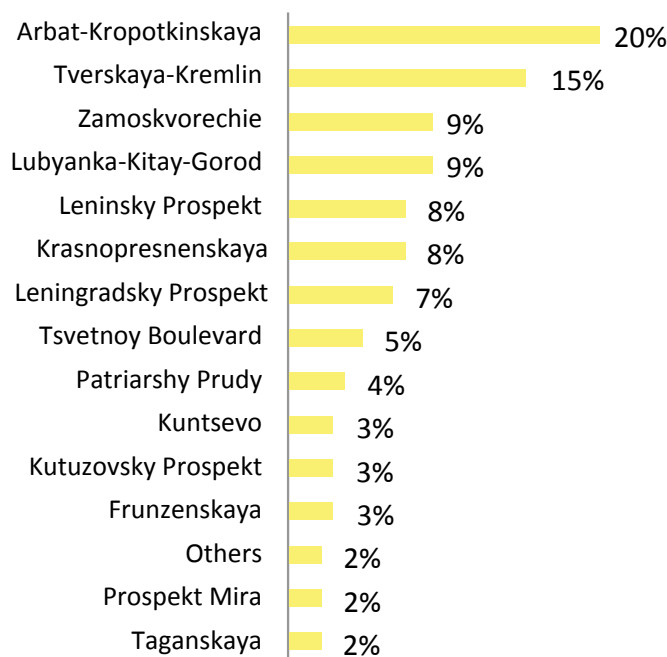
• Almost 2/3 of the proposed elite rental facilities (64%) are apartments with two or three bedrooms (35% and 29% market share respectively). At the same time one-bedroom (16%) and large apartments with 4 or more bedrooms (18%) have an almost equal share.

• USD 4,932 per property per month up to September 2016 is the average rental rate. The average rental rate in the most expensive area of the capital is 3.2 times higher than in the most affordable area.

• In the last 12 months the average rental rate of luxury apartments offered in the capital dropped by 17%.

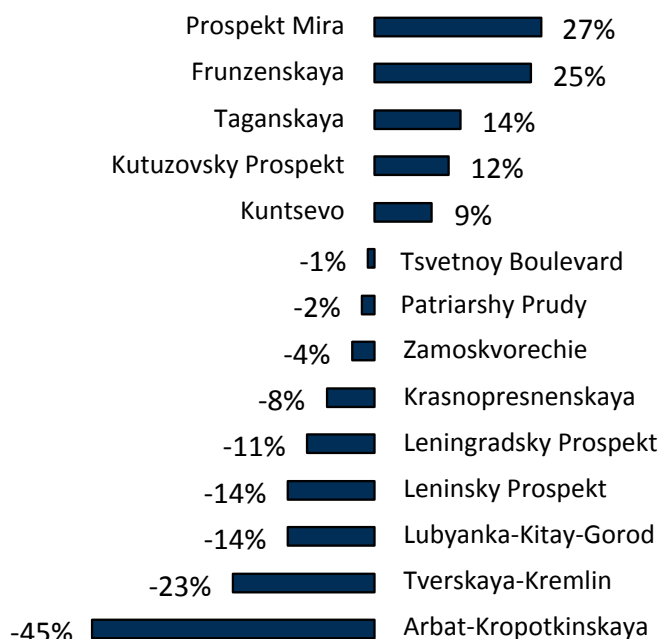
• The average rate for a studio decreased by 25% from the same period last year. **(45–46 ►)**

45 ► THE LOCATION OF APARTMENTS IN TERMS OF SUPPLY IN SEPTEMBER 2016



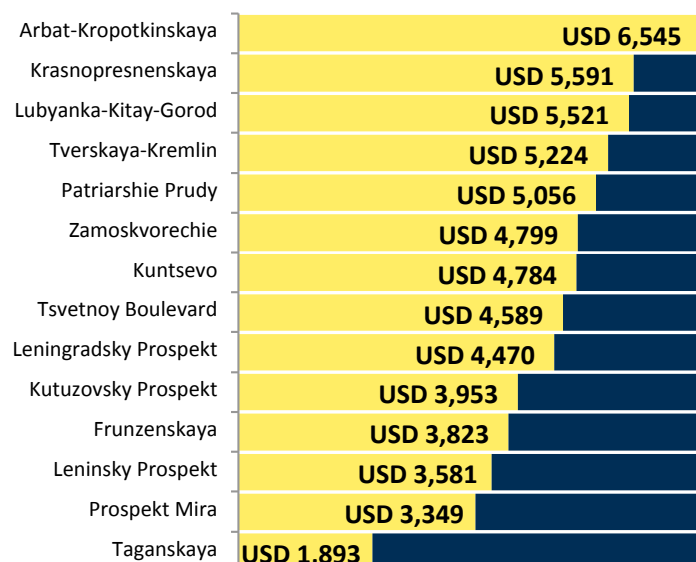
Source: Intermark Relocation

46 ► THE INCREASE IN THE VOLUME OF SUPPLY DURING 2016



Source: Intermark Relocation

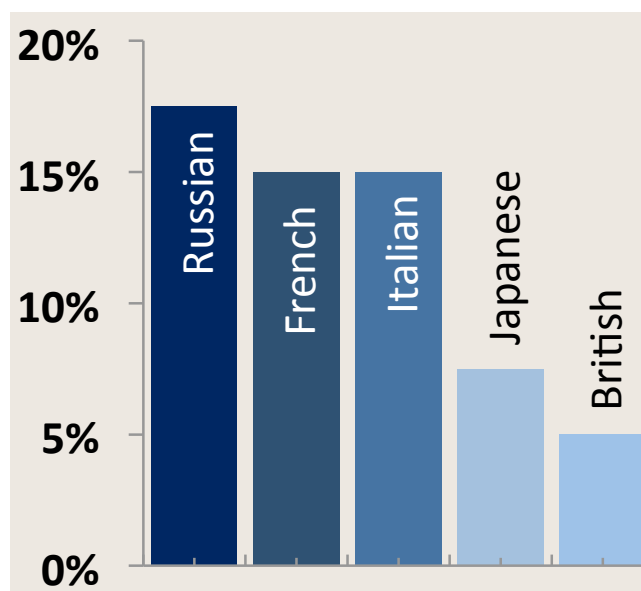
47 ► MOST EXPENSIVE AREAS IN TERMS OF AVERAGE RENTAL RATES



DEMAND

- In more than a quarter of requests from potential tenants it has been fixed as a whole for January–September 2016 compared to the same period the last year.
- In October 2016, Moscow elite rental apartments were largely in demand by Russian citizens, which accounted for over a third of the total number of requests. This means a growth in demand for luxury rental housing on the part of Russian citizens by about +10%. (47 ►)
- At the end of the third quarter of 2016, Leningradsky Prospekt was the most popular area for renting expensive apartments in Moscow. Almost one in five properties considered during this period were in this area. In recent years we have seen an increase in this indicator. For example, in July 2016 the number of requests from potential tenants increased by 6%.
- One bedroom apartments (almost 40% of all requests) were the most in-demand property in Q3 2016 according to the number of inquiries from potential tenants. The demand for one bedroom apartments/studios, as well as two-bedroom apartments (20% of requests) was equal.
- USD 3,827 per property per month was the average asking price (on the part of tenants) at the end of September 2016. It is worth noting that this figure is 20% lower than the average rental rates offered by the landlords. (48 ►)

48 ► REQUESTS BY NATIONALITY IN SEPTEMBER 2016



Source: Intermark Relocation

St. Petersburg market overview

Office market

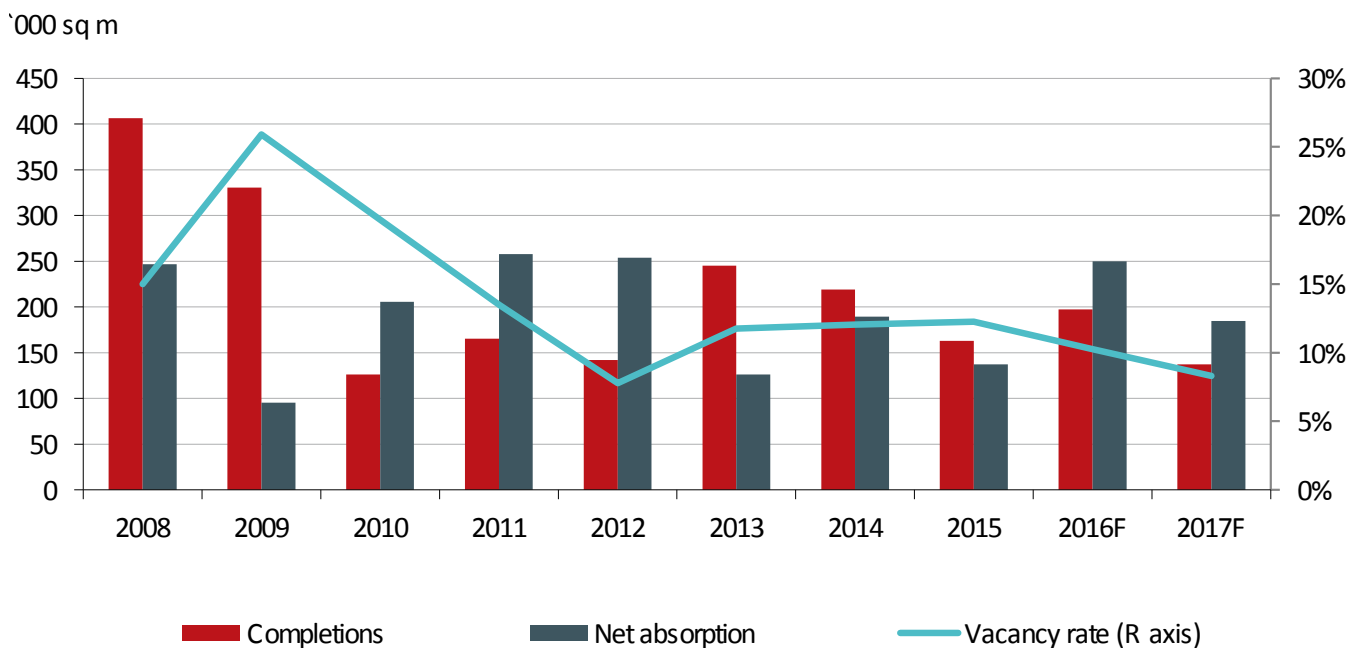
The net absorption in the St. Petersburg office market in Q1–Q3 2016 doubled YoY (186,900 sq m compared to 80,200 sq m). In Q3 2016, the net absorption reached 55,000 sq m, which corresponds to the average level for the Q3.

In Q3 2016, the modern office stock in St. Petersburg increased by two Class B buildings with a total leasable area of 16,200 sq m. If all the announced projects are delivered to the market by year-end, the volume of quality office buildings will exceed 3 million sq m.

Strong demand from the construction and IT-sectors led to a decline in vacancy rates. By the end of Q3 2016, the average vacancy rate declined by 1.4% to 10.0%. In Class A the vacancy rate dropped to the lowest level since Q4 2007, and stood at 7.3%. It also fell in Class B and stood at 11.1%.

In Q3, average asking rents stayed flat at RUB 1,586/sq m/month in Class A and RUB 1,135/sq m/month in Class B (including VAT and operating expenses). (49 ►)

49 ► OFFICE MARKET BALANCE



Source: JLL

Retail market

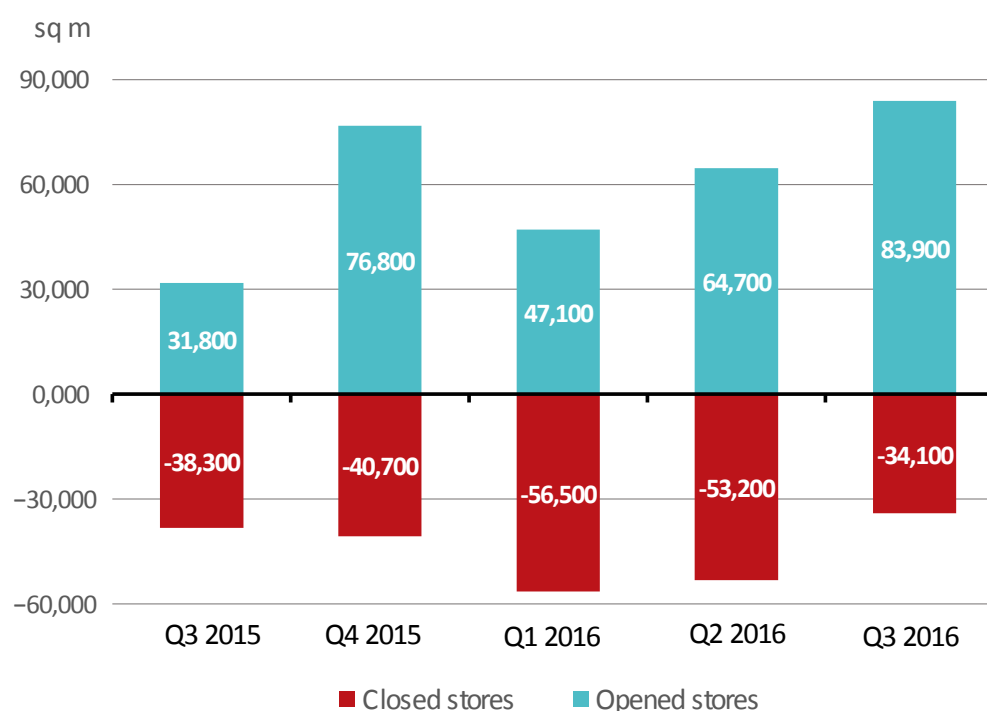
Two shopping centres opened in Q3 2016 – Okhta Mall SEC (78,000 sq m*) and Port Nahodka SEC (10,860 sq m). Currently, 58 quality shopping centres with a total leasable area of 2.25 mln sq m operate in St. Petersburg.

In Q3 2016, the vacancy level on the retail market increased by 0.9% to 6.9%, the highest level since 2011. The main reason for this was the growing supply.

Despite the increase in vacant space, the situation on the market is gradually stabilising. The total area of opened retail space in Q3 2016 exceeded the area of closed stores by 27%, excluding the newly delivered shopping centres in Q3 2016.

Prime base rents in quality shopping centres did not change and amounted to RUB 65,000–70,000/sq m/year (excluding VAT and operating expenses). (50 ►)

50 ► TOTAL AREA OF OPENED AND CLOSED STORES IN SC



Source: JLL

Street-retail market

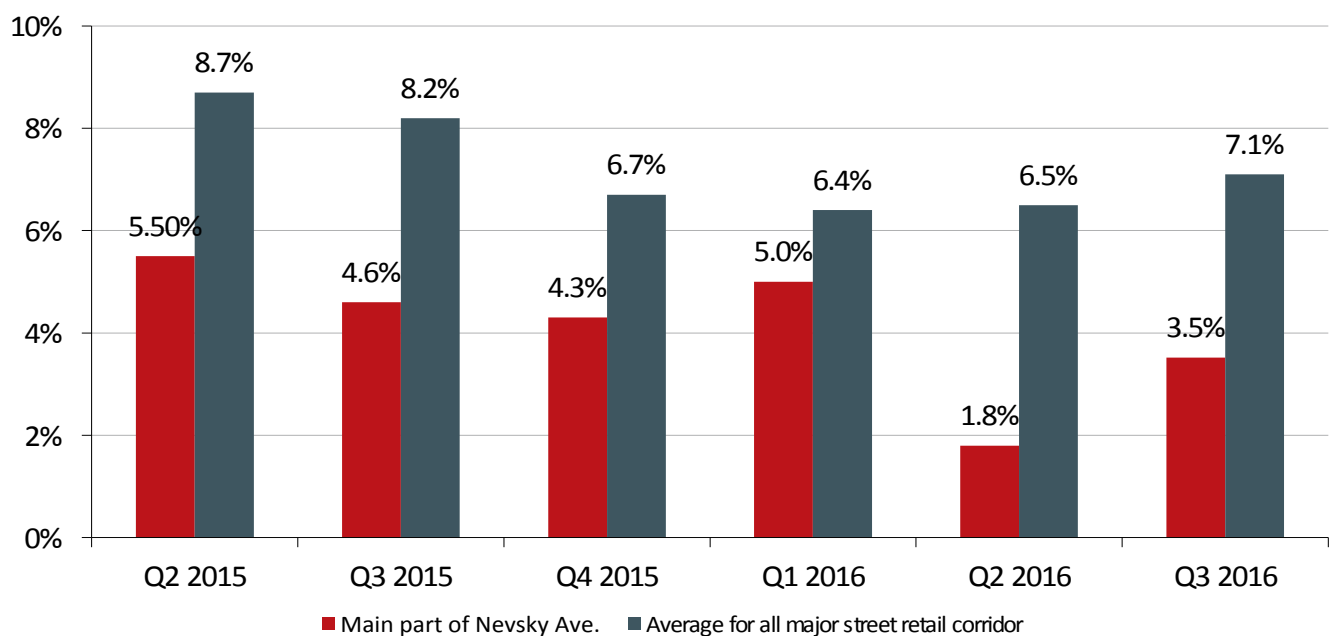
In Q3 2016, prime rents typical for the main section of Nevsky Avenue (in front of Vosstania Square) increased by 8% to RUB 13,000/sq m/month (including VAT).

In July–September, the number of closed stores exceeded the number of opened stores by 10%. At 15% of all closures, supermarkets accounted for a significant share of closed stores. Household & furnishings accounted for 12% of opened stores.

The vacancy rate on the main street retail corridors in St. Petersburg reached 7.1% at the end of the Q3, having increased in July–September by 0.6%. The most significant growth (2.8%) was observed on Vladimirsky Avenue, where it reached 10.3%. This was mainly due to the reorientation of the street retail corridor to changing customers flows.

Rotation on the main street retail corridors in Q3 2016 decreased by 2.3% to 5.5%. The current level of rotation is the lowest since Q1 2015. (51 ►)

51 ► VACANCY RATES ON THE MAJOR STREET-RETAIL CORRIDOR



Source: JLL

Warehouse market

In Q3 2016, only one warehouse complex was delivered to the market, with a leasable area of 13,900 sq m. The total quantity of warehouse stock in St. Petersburg amounted to 2.72 mln sq m.

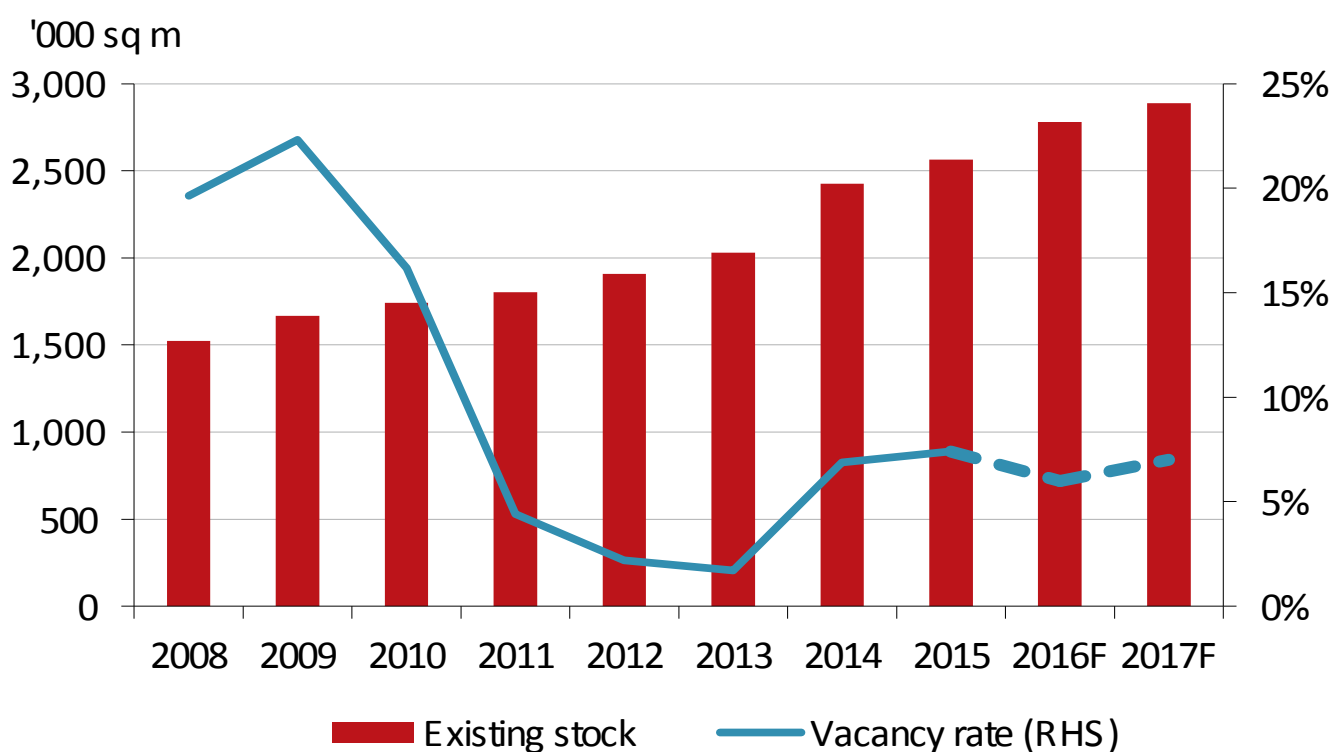
There was low activity in the development of speculative projects. The share of owner occupied warehouse complexes or built-to-suit projects continued to increase. It is expected to reach 80% of 2016 completions.

The demand on the warehouse market is weak: in Q3 2016, the available warehouse space increased by 9,500 sq m to 174,000 sq m. The vacancy rate reached 6.4%.

In Q3 2016, the average asking rental rates amounted to RUB 450–500 per sq m/month (including OpEx* and VAT). (52 ►)

* Operational expenses

52 ► SUPPLY AND VACANCY RATE ON THE WAREHOUSE MARKET



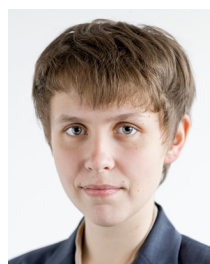
Source: JLL

Hot Topic:

Investor-initiated integrated site development: new opportunities



Sergey Trakhtenberg
Partner, Head of Russian Real Estate/Construction practice, Dentons



Tatiana Indisova
Associate, Dentons

From 1 January 2017, holders of land plots and immovable properties located on land plots will be able to get approved site development and site survey plans within one month without public hearings as part of integrated site development.

CHANGES IN TOWN-PLANNING LEGISLATION

Federal Law No. 373-FZ ("Federal Law No. 373") was adopted on 3 July 2016. It introduced numerous, often technical, amendments to the Town-Planning Code of the Russian Federation (the "Town-Planning Code") related to zoning and drafting site development plans ("proekt planirovki territorii", referred to below as the "site development plan"), and site survey plans ("proekt mezhevaniya territorii", referred to below as the "site survey plan"). However, of particular interest is the new mechanism for integrated site development initiated by the titleholders of plots and/or the immovable properties located thereon.

THE INTEGRATED SITE DEVELOPMENT MECHANISM

Federal Law No. 373 defines integrated site development as the preparation and approval of site planning documentation (the site development plan and site survey plan) for the locating of permanent residential, industrial, public and business and other structures and the necessary infrastructure, and also for the design, construction and reconstruction of such properties. It is no accident that the definition emphasises planning: a key incentive for participating in the integrated site development process today is the possibility of gaining expedited approval of the site development plan and site survey plan. By participating in integrated site development, the investor will be able to get approved site development and site survey plans without public hearings for the land planned for the construction project within 30 days from when the investor submits the prepared draft site development plan and

site survey plan to the local government authorities (the approval process currently takes an average of about six months and requires public hearings).

It is a prerequisite for integrated site development to enter into an agreement on integrated site development with the local government authorities. It follows from Federal Law No. 373 that the following will be negotiated under the agreement with the local authorities:

- (i) Division of responsibilities for the integrated and sustainable development of the site, changing the permitted use of land plots, forming plots, establishing easements, and ensuring that rights to the plots and/or the immovable properties located on them are registered.
- (ii) Division of responsibilities for site improvements.
- (iii) Obligations of the local government authority to support the construction of infrastructure needed for permanent facilities sited as part of integrated site development to operate, and support human activities, or the obligations of titleholders to ensure that such infrastructure is put in place at their own cost in accordance with the early design and construction schedules.
- (iv) Types of incentives provided to titleholders and the conditions for their provision in accordance with the Town-Planning Code, legal regulatory acts of the Russian Federation constituent entities and municipal legal acts.
- (v) Compensatory measures (provision of tax incentives, land plots of equal value, reduced rent, etc.) if the agreement provides for the locating of infrastructure on the titleholder's plot.
- (vi) Terms and conditions for transferring infrastructure built at the titleholder's expense to local government authorities free of charge, etc.

Federal Law No. 373 includes only general requirements for the integrated site development agreement and does not detail the process of how integrated site development is done, the only exception being the conditions for the parties to repudiate the integrated site development agreement out of court. For example, if the titleholder repudiates the integrated site development agreement this will invalidate the approved site development plan and site survey plan for the plot. Also of particular note

is that the local government authority may repudiate the agreement if the investor is late in performing integrated site development, including building infrastructure, and claim losses.

WHO IS ENTITLED TO PERFORM INTEGRATED SITE DEVELOPMENT AT THEIR OWN INITIATIVE?

The following may initiate integrated site development:

- (i) The owner of a land plot and/or real estate properties located on that land, or
- (ii) The tenant or person using the state or municipally owned land plot for free, provided the person who is not the owner of the plot and/or real estate on the plot is entitled to use the plot on the date of the integrated site development agreement for at least five years.

If two or more titleholders are the initiators, then before applying to the administration they enter into an agreement on the division of responsibilities for integrated site development setting forth their mutual obligations related to the implementation of integrated site development and the terms for sharing expenses and income from the implementation of their investment projects through integrated site development.

It is important that under Federal Law No. 373 titleholders prepare site planning documentation as part of integrated site development for the land within the boundaries of the plots whose titleholders executed the agreement. Considering that public hearings will not be held on draft site development plans and site survey plans, neighbouring landowners and other third parties will have almost no opportunity to influence the approval of the site development plans and site survey plans of titleholders participating in integrated site development, which will expedite the approval process.

BASIC STAGES OF INTEGRATED SITE DEVELOPMENT

Federal Law No. 373 envisages the following procedure for carrying out integrated site development:

- (i) The titleholder(s) send(s) the local administration the prepared site development plan and site survey plan, the agreement on the division of responsibilities (if there are

at least two titleholders) and the draft integrated site development agreement setting forth only the titleholders' rights and obligations.

(ii) The local government authority checks the site development plan and site survey plan for compliance with the requirements of the Town-Planning Code within 30 days of receiving the drafts and approves the site development plan and site survey plan without public hearings or decides to reject the drafts and return them for revision.

(iii) The local government authority enters into an integrated site development agreement with the titleholder(s) without an auction for a term of not more than 15 years and sends it to the titleholder(s) within 30 days of approval of the site development plan and site survey plan.

(iv) The titleholder(s) sign(s) the agreement within 30 days of receiving the agreement and begin to perform their obligations.

Federal Law No. 373 does not generally detail the procedure for negotiating the terms of the integrated site development agreement, nor does it detail the negotiation of incentives and compensatory measures. One can already suppose that the integrated site development structure will follow the principle of a tailored approach to investors and it will be most attractive for groups of investors planning to implement mixed-use projects on adjoining plots. In that case, the integrated site development model will help participants to considerably reduce the amount of time needed to approve site planning documents with the required parameters and, together with the local government authorities, to settle on the conditions for creating the necessary infrastructure and site improvements. |

Hot Topic:

Recent updates on the mortgage market



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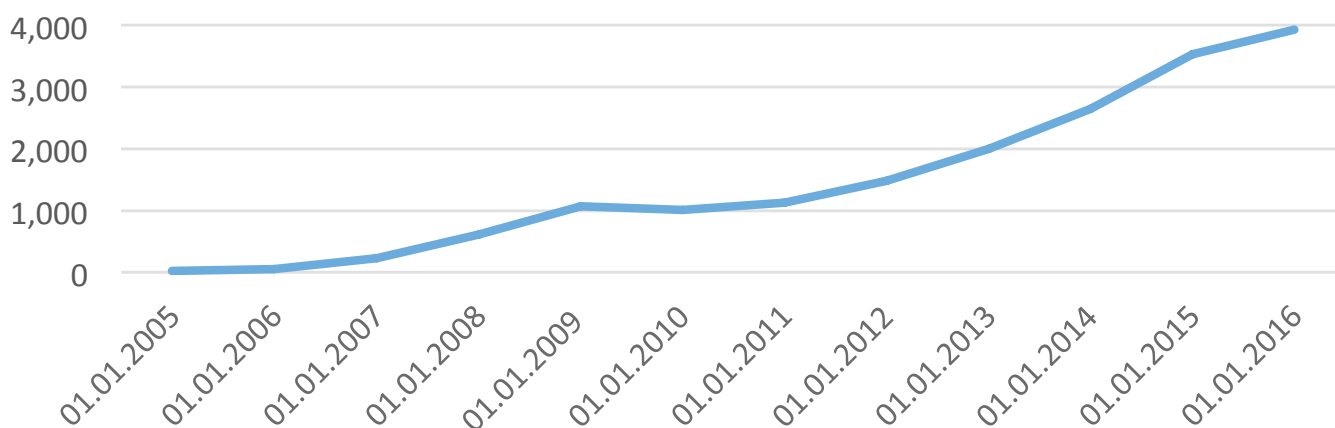
The future of mortgage lending in Russia in light of the continuing recession is worrying ever more people, including not only bankers, investors, realtors and developers, but also a considerable number of Russian consumers, who potentially need to improve their living conditions.

A positive factor in relation to the mortgage market is that the potential of the Russian mortgage market has up to now only been 33% realised (according to different

estimates), and as mortgages are one of the key needs of most people, there are reasonable grounds to expect that this market will grow.

The growth of residential mortgage arrears is presented in the graph below. This visually points to the fact that there are many opportunities, and we may see growth in this lending segment in the nearest future despite the negative factors related to decreasing household incomes which in turn give rise to a high risk of non-payments. (53 ►)

53 ► MORTGAGE DEBTS, BILLION RUB



Source: Rosstat, CBR

Another important positive aspect is related to the government mortgage support programme launched in March, 2015. This programme provides significant help in minimising the effect of the drop in demand for mortgages. At the same time the fall in demand increased competition in the market. And this is also a good sign which brings hope that new higher quality products will be made available on the market to attract more potential clients.

It is important to note that the turbulence in the banking sector connected with the constant license revocations could also have a positive impact on the mortgage market. The trend in banking towards integration could lead to the emergence of new players who enter the market with new ideas, as opposed to traditional technologies, that are of interest at this time. It is clear that the technologies utilised in the Russian mortgage market are currently less developed than Western technologies, and developmental trends are clear. Mortgages are primarily taken out by so-called "good" clients with an excellent credit reputation. Usually these are young families with good career growth prospects. Normally these people are taking such a serious financial decision for the first time in their life, thinking over all the consequences and estimating all possible credit risks beforehand. As a result, banks acquire not only sustainable collateral but also "good" borrowers. On the other hand, new technologies are required. It is important to understand that young professionals are used to dealing with most issues online. The ability to perform all banking procedures remotely using electronic document flow systems is often quite important for them and banks should be able to provide them this service.

One more positive factor is the recent fall of the CBR rate by 0.5%, which in line with the forecast on falling inflation has led banks to decreasing their mortgage rates.

A negative factor is related to the ongoing discussions about the termination of government support. The Government of Russia does not plan to continue providing support after 31 December 2016. This will undoubtedly lead to an increase in rates and make the product less attractive. However, in this context there have been ever more discussions about the other two innovations in the

mortgage business. The first is the reverse mortgage.

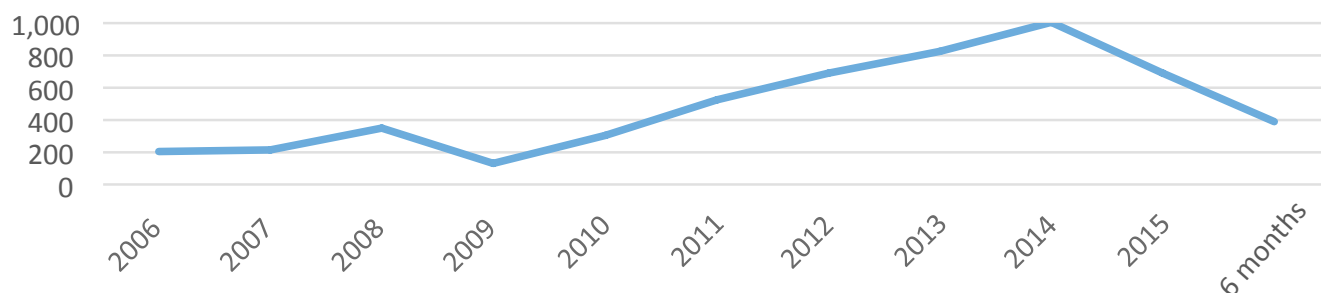
The idea to promote this instrument belongs to the Ministry of Finance of Russia. The Housing Mortgage Lending Agency (HMLA) put forward such an idea about four years ago, which failed, but the Ministry of Finance plans to launch this instrument anyway. Via this instrument an elderly person signs an agreement under which he or she receives money equal to the average cost of his apartment from a bank on a monthly or annual basis. His or her apartment is considered as collateral. He or she does not need to pay interest on the loan, the interest will be gradually added to the principal amount of the loan. And when the accumulated sum of the loan exceeds the estimated price of the apartment, the elderly person can continue living in the apartment and keep the title to it. And only after his or her natural death the apartment is sold as collateral, and the heritors receive the funds from the sale excluding the debt to the bank. The sum paid to the elderly person is less than the market value of the apartment at least in terms of the loan interest and adjustment of realtors.

Experts in the real estate market have different opinions on this idea. There is the belief that it is a rather interesting and new product in the form of no-purpose loan. It could help to bring retired people in to the economy and thereby to launch a new stage of development of the mortgage market, which is crucial at a time when the popularity of unsecured lending is decreasing.

The second innovation in the mortgage market is the adoption of the transaction certificate of the propitiate project "Mortgage and rental housing" by the Government of Russia in October 2016. The project began on 1 November 2016 and should finish on 31 December 2020.

The stated goal of the project is to improve the living conditions of Russian consumers through the provision of a large quantity of new housing (88 million square meters in 2018, 100 million square metres in 2020) and through demand stimulation (provision of 1 million mortgages in 2018 and 1.2 million mortgages in 2020, the attraction of RUB 15 billion of investment in 2018 for the construction of rental housing). Based on mortgage statistics over the

54 ► QUANTITY OF MORTGAGES, THOUSAND LOANS



Source: Rosstat, CBR

last 10 years these programme goals are not too ambitious. In the graph below, it can be concluded that the Russian Government is going to return to the quantity of loans issued in 2014 in 1–1.5 years, which is rather realistic under certain circumstances. (54 ►)

In order for the mortgage market to grow, it has been proposed to issue mortgage securities with HMLA guarantees. These instruments should provide banks with equal access to the sources of long-term financing of mortgages and to credit risk management instruments. Thanks to the increase in liquidity and the decrease in credit risk of the bank, consumers could receive lower mortgage rates as well as a sustainable financial savings investment instrument.

The HMLA, as an institute of development, will use the collective investments instrument on the basis of closed real estate mutual investment funds. The HMLA will act as a general investor of these funds and create a sub-

sidary asset management company – the united development institute, to manage the mutual investment funds.

According to different estimates, if the project was successful it could lead to a decrease in mortgage rates of about 1%, which would make mortgages available for more people. Considering that according to CB RF data the weighted average interest rate of mortgages in roubles is now about 12.5%, this is quite positive news.

It is clear that there are at least three general factors affecting the further growth of mortgages at the present time: firstly, the large potential of the market; secondly, the need to improve lending technologies and understand technology trends; thirdly, government support. Taking into account the good practice and experience of players in the Russian mortgage market, it is clear that despite the great amount of work that needs doing in this respect, positive results can be expected soon. |

Hot Topic:

Another way to gain a return on investment in building engineering systems automation



Alexander Nevrovskiy
Head of Marketing in Building
Technologies, Siemens LLC

Statistics on the construction and use of buildings in Europe show that 80% of building lifecycle costs are associated with the maintenance stage. At the same time only 20% is associated with the construction of the building itself and its engineering systems.

If we take a closer look, we find that this 80% can be broken down: 40% for power consumption, 30% for building maintenance and 10% for other costs.

What is 40% for power consumption? First of all, this means payment for heating and hot water supply systems, as well as electricity bills.

A well-known way to cut these costs is to automate building heating, ventilation, air conditioning and power distribution systems. In the real world this is implemented via systems that turn on space heating only when humans are present, workplace lighting control, and by shading the windows to avoid overheating and subsequent cooling of the rooms.

This is the traditional approach to the assessment of return on investment when automating building engineering systems in Europe. It should be noted that it is already utilised in Russia. Another trend rapidly gaining momentum in Europe is the understanding of how the right building climate affects the financial performance of the company working in it.

The starting point here is as follows: a person is by nature used to being in one's natural environment, where he/she feels most comfortable, where he/she does not get excessively tired, where he/she can maintain focus for a long time. This enables the person to work as efficiently as possible and make fewer errors.

When a person is in the building, i.e. he/she is working in the office, the above parameters are affected by various factors such as temperature conditions, air quality and humidity, and lighting. When such conditions are unnatural, the person starts to feel bad, and you can often hear him/her say "I feel so tired today", which is perceived as

a result of the work done by the employee. However, the irony is that once the employee is outside, his/her physical state instantly improves. A reasonable question in this case is what has really made this person tired; his/her work or the conditions in which he/she performed the work.

To describe this effect international practice has introduced the term "Sick Building Syndrome", which is already known in Russia by the same name.

Now let's go back to the building with our employee, to his/her workplace and see what is really going on there. What is dramatically reducing, using managerial language, his/her efficiency and performance?

1. Poor air quality means a higher CO₂ concentration. That leads to reduced focus and more errors. This is not only important for people in the office, but also for those in educational institutions, hospitals, and government agencies where a large number of decisions are made every minute in a stressful environment (e.g. airport flight services, emergency coordination centers, etc.). The estimated reduction of efficiency caused by poor air quality is 11%.

2. Lack of daylight is a reason for the employee's bad mood. You can't expect the employee to generate new ideas or even perform preset operations well when he/she is in a bad mood. Bad lighting can reduce efficiency by 23%.

3. Wrong temperature, perceived by the employee as "I'm feeling cold" or "I'm hot" decreases labour efficiency due to discomfort. If temperature is comfortable, an employee's efficiency can increase 3%.

Moreover, a bad climate is one of the co-factors for the spread of viruses, which can result in a person's absence for 1–2 weeks.

It would seem that the numbers detailed above mean almost nothing to the employee: 3%, 11%, 23%, as it is quite hard to actually feel it. What is a labour efficiency improvement of 3%? However, when it comes to a team

of, say, 50–100 employees, 3% and, moreover, 23% is an entirely different thing. Especially, if you have the opportunity to control all these parameters via automated engineering systems.

The company's management is unlikely to reject the opportunity to improve the efficiency of the team by 23% in the competitive environment.

Let's go back to ensuring that improvement is made in the aforementioned parameters. 11% for air quality can be achieved by properly adjusting the building ventilation system. The key word here is system, including: air exchange valves, air quality (CO₂ concentration) sensors, and management system controllers.

The light control system enables the lighting to be adjusted correctly. Workplace lighting sensors and controllers do the trick here. In case of lack of daylight it is offset by light lamps, however, daylight will obviously have priority.

The temperature is controlled via temperature sensors and control devices located on radiators, convectors and controllers managing the whole system, as well as by exchanging data regarding the building heat demand.

And do not forget the one thing we mentioned at the beginning of this article – engineering system automation will enable power consumption costs to be cut. Here are some numbers: a correctly customised heating system brings about savings of up to 30% of heating costs.

So, except for these easily measured power costs, companies whose employees work in a "healthy" building gain from improved labour efficiency. |



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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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