2/2014

# AEB REAL ESTATE MONITOR

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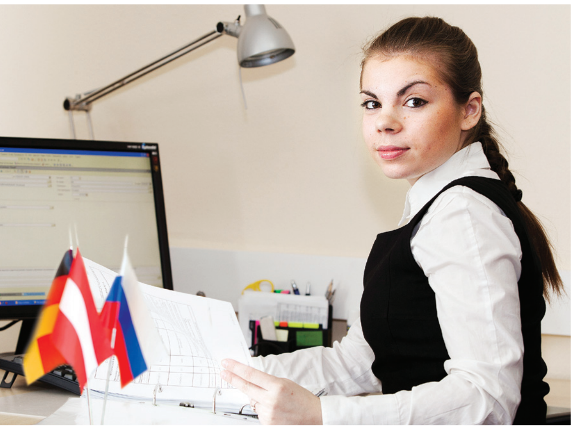

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**Frank Schauff**
Chief Executive Officer,
The Association of
European Businesses

# Dear readers,

Welcome to the second issue of Real Estate Monitor in 2014.

The first half of this year has turned out to be quite a difficult period for the Russian real estate market. In particular, as a strained situation in and around Ukraine developed, investors became more hesitant about putting their money into Russia.

But now, in spite of the complicated political and financial situation, involving an economic slowdown and a weakening rouble, the mood of investors is slowly beginning to show the first signs of improvement.

The Real Estate Committee of the AEB 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.

I would like to take this opportunity to thank those of our Real Estate Committee members who have been active in contributing to this publication and to the other activities of the Committee.

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

Sincerely yours,
**Frank Schauff,**
Association of European Businesses

**Victor Verma**
General Manager,
OOO Caverion Elmek;
Chairman of the AEB
Real Estate Committee

# Dear readers,

We are happy to present to you the second issue of the AEB Real Estate Monitor for the 2014.

So far, this has been a challenging year for investors. Political events have disrupted financial markets. The rouble has weakened. Experts have been giving contradictory assessments and forecasts. Periods of capital outflow have alternated with periods of inflow.

Investors have become more cautious and many have put projects on hold. These delays may extend well into next year. On the other hand, the Russian commercial real estate market is generally in pretty good health. Investors have fewer financing concerns and hence forced sales of properties are less likely. They are not yet ready to accept discounts related to increased political and economic risk.

A powerful consumer base and the large economy allow us to believe that when the dust of the current extraordinary events settles, we will have a real chance for upward revisions in growth forecasts. 2014 could well build a base for a better 2015.

Real Estate Monitor analyses markets of various types in the capital. You can match the value of property and make better-informed decisions. We hope this publication will be a valuable source of information for you.

I am glad to be able to take this opportunity to thank all the members of the Real Estate Committee for their contributions, their active role and their trust.

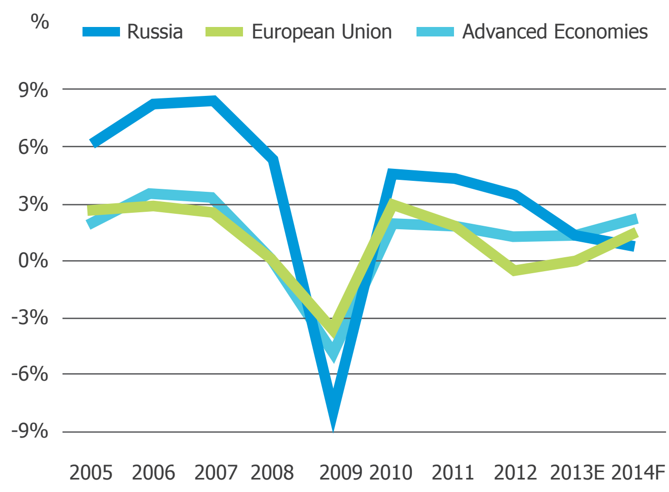
Sincerely yours,

**Victor Verma**

# Capital market

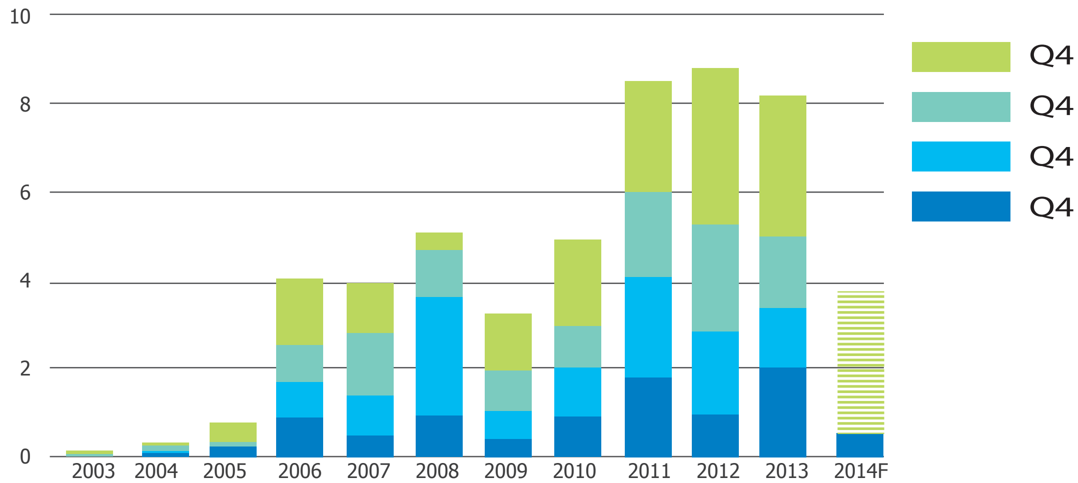
**The first quarter of 2014 was marked by considerable political and economic uncertainty.** The uprising in Kiev followed by Russia's intervention in Crimea has led market analysts to review their growth forecasts for Russia in 2014. The World Bank who, in 2013, had already revised their growth forecast from 2.3% growth to 1.3% made yet another revision for Russia, revising their official forecast to 1.1% and acknowledging that there are downside risks even to this number. (1 ▶)

### 1 ▶ GDP GROWTH, %, P/A




Source: JLL

### 2 ▶ COMMERCIAL REAL ESTATE INVESTMENT VOLUMES, $ bn




Source: JLL

**For the commercial real estate market, the primary transmission point for political uncertainty was the rouble.** Over the quarter, the rouble averaged 35.12/USD, compared to an average of 32.55/USD over the fourth quarter of 2013. This weakening trend has been combined with considerable intraday volatility that has made currency forecasting beyond a few days a near impossibility.

**In light of the recent economic downgrades, and continued political uncertainty we have made significant downward revisions to our 2014 investment volumes assumptions.** With the economy under pressure and investor sentiment uncertain, we have revised down their expectations for investment volumes for 2014 to USD 3.4 bn from the USD 7.0 bn forecast at the start of the year. This downgrade in our 2014 forecast implies that investment levels could be the lowest in post-crisis period and comparable to total investment volumes in 2009 when investment volume reached USD 3.2 bn (2 ▶)

**Q1 2014 investment volumes were 73% down on Q1 2013.** The total investment volume in Russia reached USD 545 m in Q1 2014, which is 73% lower than the same period last year. Though the market was undoubtedly subdued due to the conflict in Ukraine, it should be noted that this large drop is largely a result of a record high volume in Q1 2013 (due to the sale of Metropolis SC) and quite a large volume of deals that closed at the end of 2013.

**We anticipate that the role of foreign investors will diminish markedly in 2014 versus 2013.** So far this year, the market remains almost balanced between Russian and foreign investors with their shares amounting to 57% and 43% of total investment volume in the first three months of 2014 correspondingly. However, we expect the share of foreign capital to be volatile through the rest of the year.

# Office market

Growth in supply is expected to slowdown in the near-term. About 209,048 sq m of new office space was delivered in Moscow in Q1 2014 bringing the total volume of office stock to 15.8 m sq m. The volume of new deliveries in Q1 2014 was 19.5% lower YoY than for the same period last year. By the end of 2014, we expect the total stock of Moscow office space to increase by 6.7% YoY and reach 16.7 m sq m. (3 ▶)

Macroeconomic uncertainty puts pressure on demand. The estimated volume of take-up for the last quarter dropped by 25% YoY to 258,706 sq m, with the share of pre-lets in take-up coming to 11.8%. We believe the changes in the macro environment will be the main factor affecting demand for offices this year. For 2014 we expect the volumes of take-up to be about 1.3 m sq m.

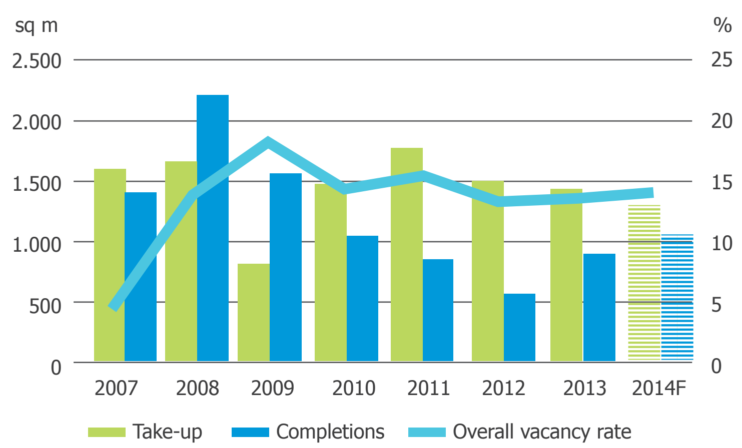
Growing supply will affect overall vacancy rate in 2014. Vacancy levels for Class A office spaces in Q1 2014 reached 20.8% mainly due to the new supply of higher quality office buildings. In Class B+ the overall vacancy rate remained at about the same level seen in previous quarter and stood at 12.9%. Over the year we expect to see the overall vacancy rate ticking up to 14% compare to 13.7% seen in 2013. (4 ▶)

Rents are affected by macro factors. The biggest pressure on rents is seen currently in the Prime office segment which we attribute mainly to the recent rouble devaluation. Over the last quarter, prime rents decreased slightly to USD 900–1,100 per sq m per year. Nonetheless, the level of base rents across the market remained largely stable. In our view, in the current environment tenants have increasing negotiation power, given the greater opportunities on the market in terms of price and quality, while still absorbing similar levels of high quality office spaces compare to figures seen a year ago.

### 3 ▶ OFFICE SUPPLY


Source: JLL

### 4 ▶ OFFICE DEMAND




Source: JLL

Industrial zones: one of the sources of future supply in Moscow. Soviet era industrial zones, particularly in the East and South-East of Moscow will offer opportunities for redevelopment for different real-estate classes including offices, in our view. For 2014, the main large-scale projects are former ZIL and Serp i Molot industrial plants. Legislation amendments are encourage this process: increasing tax burden for smaller owners of obsolete buildings in industrial zones will force them either to improve the quality of buildings by means of redevelopment or to sell them on to potential investor.

# Retail Market

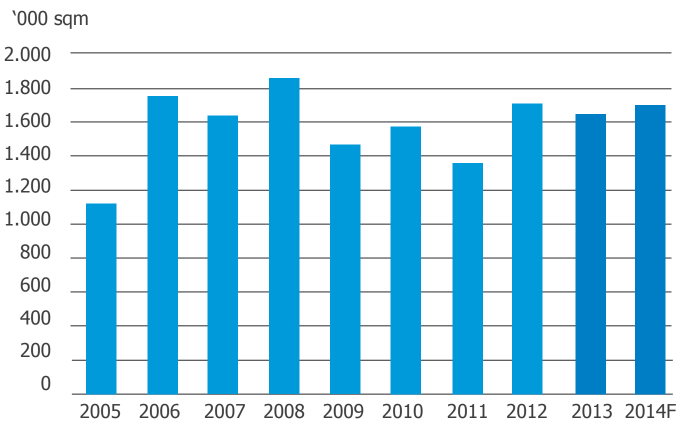
Q1 2014 was marked by significant downward revisions in the macro economic outlook. A weakening rouble along with a decrease in GDP and income growth forecasts have affected retail demand. Several retailers have acknowledged pressures on revenue, and more than a few have reviewed their development plans.

The Russian market saw less than 170,000 sq m of new premises in Q1 2014 which is less than in Q1 2013 (305,000 sq m). However, this is not yet a question of stagnation in our view. Rather we believe that the relatively low level of completions is primarily due to the high completion level in Q4 2013 (more than 800,000 sq m). The Moscow market received 59,100 sq m of new premises which is much more than in Q1 2014 (5,500 sq m). We are still think that there will be, by year end, a record level of new completions in Moscow. The Moscow market is likely to be replenished with more than 600,000 sq m of new premises or 35% of completions in Russia. In 2013 12% of completions across Russia were accounted for by Moscow. (5 ▶)

As of at the end of Q1 2014 macroeconomic turbulence has not yet affected the vacancy rate in Moscow shopping centres which remained at the level of 2.5%. However we anticipate this to rise to 4-4.5% by the end of the year. Rental rates have remained stable though we think they could well come under pressure before the end of the year. Saying that, we believe that demand for top quality retail outlets is still high, and expect that for prime, rental rates will remain well supported. In the regions, we are seeing evidence of retailers putting pressure on rents and the same goes for under construction projects in Moscow. However, at the moment developers apear ready to negotiate alternative measures instead of decreasing the rents (for example fixed currency range). (6 ▶)

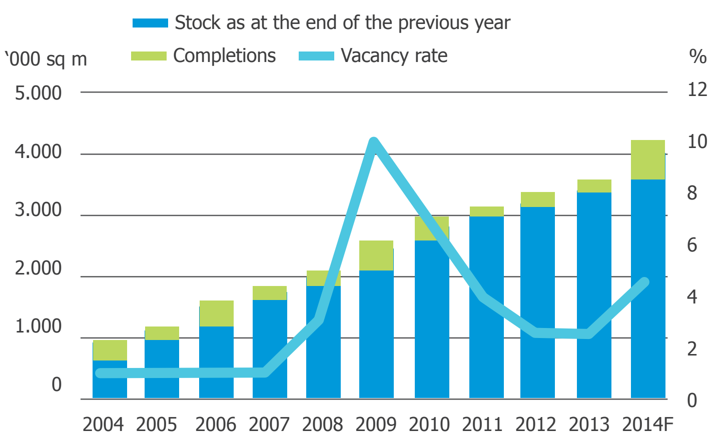
The street retail market has also been affected by economic pressures. Tenants have become more cautious about renting premises and some of them have reviewed their development plans. However, if the economic situation stabilizes we would expect retailers to turn less risk averse in order to ensure new openings before the start of high season in the autumn.

**5 ▶ RETAIL COMPLETION DYNAMICS**




Source: JLL

**6 ▶ RETAIL MARKET BALANCE**




Source: JLL

# Warehouse and Industrial

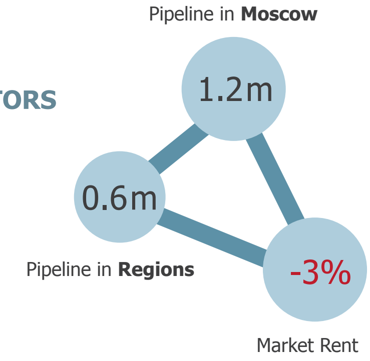
## Summary

### THE MOSCOW REGION

Construction activity in the Moscow Region remains high. During Q1 240,000 sq m of quality warehouses were delivered, a record volume for the last five years. On average, quarterly construction for the last five years has been 120-160,000 sq m.

Tenant activity was also rather high. Absorption was almost the same as last year - 112,000 sq m against 114 000 in Q1 2013. The vacancy rate increased 0.5pp, but still stayed within the frictional 2%, which shows a continued shortage in ready-to-move warehouses. (7 ▶)

### 7 ▶ MAJOR INDICATORS




Source: Cushman & Wakefield

### REGIONS

Supply outside Moscow increased 72,000 sq m for the quarter. The construction rate is 20% lower, than in Q1 2013. Within the first three months, a record 100,000 sq m of warehouse space was absorbed since 2008.
In general, rental rates for the quarter remained stable, and a trend for vacancy reduction was observed.

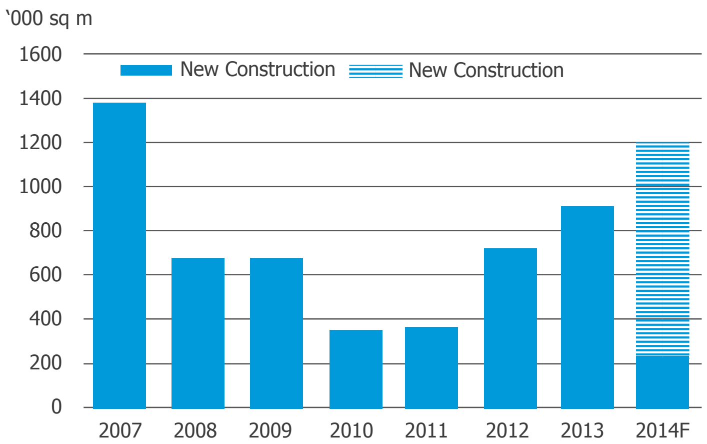
## Construction

In Q1 2014, more than 240,000 sq m of new warehouses were delivered. The biggest new warehouse property is the first building of the PNK-North warehouse complex (55,320 sq m). Most of the other new supply comes from smaller Class B buildings.

In 2014, we expect that 1.2 million sq m of new warehouses will be delivered in the Moscow Region. Most of the new space is planned for the Leningradskoe Highway (more than 400,000 sq m), and the Novoryazanskoye (more than 350,000 sq m) and Kashirskoe Highways (more than 250,000 sq m).

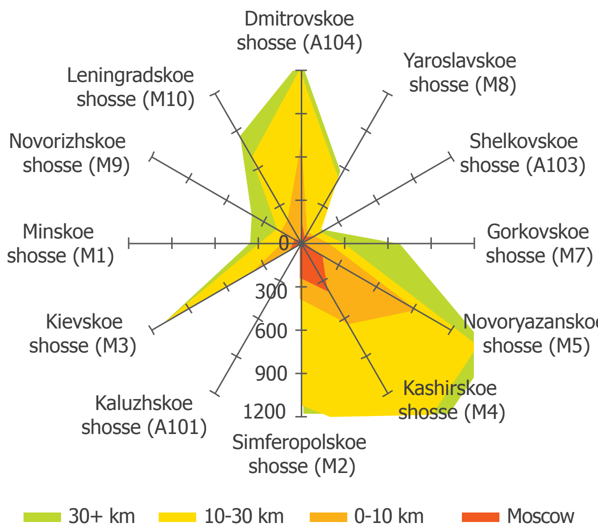
In other regions, new quality premises opened in Chelyabinsk and Novosibirsk. In total, more than 72,000 sq m of new warehouse space has been delivered in Q1. According to announced developer plans, more than 600,000 sq m of new warehouses will be built during 2014 outside the Moscow Region. (8, 9, 10, 11 ▶)

### 8 ▶ NEW CONSTRUCTION IN THE MOSCOW REGION




Source: Cushman & Wakefield

### 9 ▶ GEOGRAPHICAL DISTRIBUTION OF QUALITY WAREHOUSE SPACE BY HIGHWAY, THE MOSCOW REGION ('000 SQ M)




Source: Cushman & Wakefield

### 10 ▶ MOSCOW NEW CONSTRUCTION, 2014

| Project | Highway | Distance, km | Total Area, '000 SQ M | Delivery, Quarter |
|---|---|---|---|---|
| PNK - North | Rogachevskoye | 27 | 55,32 | Q1 |
| Bykovo Technopark | Novoryazanskoye | 19 | 61,42 | Q2 |
| Dmitrov Logistics Park | Dmitrovskoye | 30 | 69,30 | Q2 |
| Nikolskoye Logopark | Rogachevskoye | 35 | 104,97 | Q2 |
| PNK - Chekhov II | Simferopolskoe | 50 | 143,57 | Q2-Q4 |
| PNK - North | Rogachevskoye | 27 | 107,45 | Q3 |
| Sofyino Technopark | Novoryazanskoye | 32 | 84,97 | Q3 |
| South Gate Industrial | Kashirskoye | 27 | 129,00 | Q3 |
| Radumlya logistic park | Leningradskoye | 19 | 154,43 | Q4 |
| Sever II logopark | Leningradskoye | 30 | 99,56 | Q4 |
| Nova Riga logistic | Novorizhskoye | 21 | 67,39 | Q4 |

Source: Cushman & Wakefield

### 11 ▶ NEW CONSTRUCTION*, RUSSIA EXCEPT THE MOSCOW REGION, 2014

| Project | Highway | Total Area, '000 SQ M | Delivery, Quarter |
|---|---|---|---|
| Logocenter | Chelyabinsk | 34 | Q1 |
| Tolmachevo Logopark | Novosibirsk | 45 | Q1 |
| a2Logistic | Ekaterinburg | 52 | Q4 |
| Logocenter Kuban | Krasnodar | 38 | Q3 |
| Sever Logopark | Novosibirsk | 40 | Q3 |
| a2Logistic | Rostov-on-Don | 33 | Q3 |
| Armada Park | St. Peterburg | 79 | Q3 |
| Osinovaya Roscha | St. Peterburg | 42 | Q3 |
| PNK KAD | St. Peterburg | 65 | Q3, Q4 |

* Key quality warehouse

Source: Cushman & Wakefield

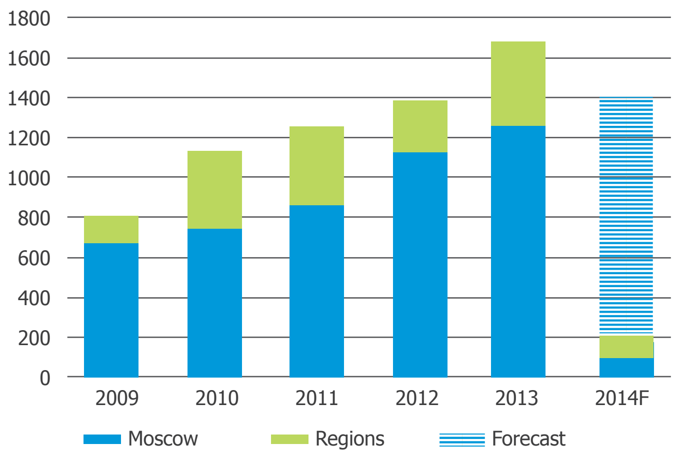
# Demand

In Q1 2014, the total volume of warehouse deals in the Moscow Region reached 112,000 sq m. 17% of these deals were property sale transactions. Tenants' activity is similar to the previous year.

Average lot size decreased considerably: in Q1 it was about 9,000 - 10,000 sq m, whereas in 2013 average deal size amounted to 18,000 sq m. Production and retail companies are still the most active industries on the market. Outside the Moscow Region in Q1 2014, take-up was more than 100,000 sq m and this was a record quarterly volume. Average lot size remained 10,000 sq m. The share of sale transactions is 20% from total take-up.

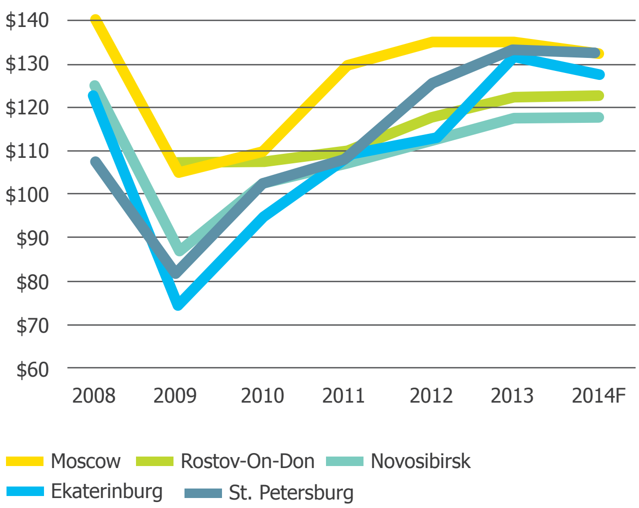
Similarly to the Moscow Region, retail and production companies generated most of the demand. (**12, 13 ▶**)

**12 ▶ TAKE UP, '000 SQ M**




Source: Cushman & Wakefield

**13 ▶ RENTAL RATES IN MAJOR RUSSIAN CITIES CLASS A**




Source: Cushman & Wakefield

# Trends

In Q1 2014, for the first time since 2008, rental rates started to fall. The warehouse real estate market reflected the country's economic and political uncertainty in the country. As a result, the volume of closed deals in 2014 might be lower than in previous years (2012-2013).

New construction outlook remains unchanged at a level of 1.2 m sq m. About 50% of warehouses under construction are built to suit premises for end users.

Outside Moscow the demand for quality warehouse space from production companies is expected to be high. Most retailers haven't completed construction of their distribution networks following rapid regional expansion. As a result, rents will remain stable. (**14, 15, 16 ▶**)

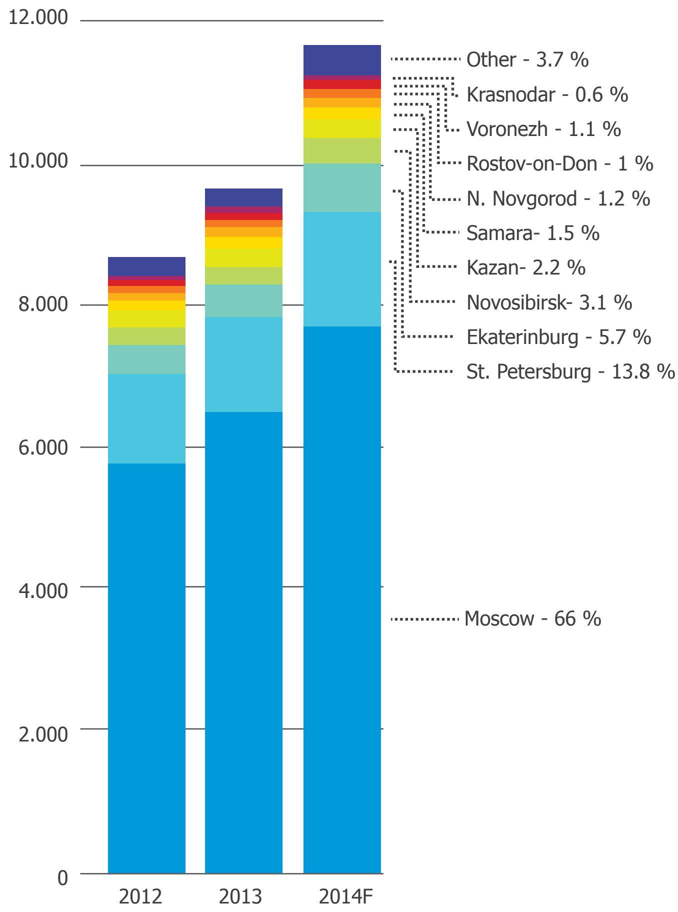
## 14 ▶ RENTAL RATES IN MAJOR RUSSIAN CITIES CLASS A

| City | Avg base rental rates, USD / annum | | Avg leased area, sq m |
|---|---|---|---|
| | min | max | |
| Moscow | 130 | 135 | 10,000-15,000 |
| St. Petersburg | 130 | 135 | 2,000-10,000 |
| Ekaterinburg | 125 | 130 | 5,000-10,000 |
| Nizhny Novgorod | 120 | 125 | 3,000-5,000 |
| Samara | 110 | 115 | 3,000-5,000 |
| Kazan | 90 | 100 | 3,000-5,000 |
| Rostov-On-Don | 120 | 125 | 3,000-5,000 |
| Krasnodar | 120 | 125 | 3,000-5,000 |
| Novosibirsk | 110 | 125 | 2,000-5,000 |
| Ufa | 120 | 125 | 3,000-5,000 |

## 15 ▶ LEASE TERMS IN MOSCOW

| | | CLASS A | CLASS B |
|---|---|---|---|
| Net Rent Rates | $/sq m/year | 130 - 140 | 120-130** |
| Operating Expenses | $/sq m/year | 35 - 45 | 20-30 |
| Utility Charges | $/sq m/year | 10 - 15 | 10 |
| Yearly Rent Indexation | $/sq m/year | CPI-3%/3.5% | 8-10% |
| Minimum Lease Term | $/sq m/year | 5 - 10 | 1-3 |
| Contract Security | $/sq m/year | 3 - 6 | 1-3 |
| Advance Payment | $/sq m/year | 1 - 3 | 1-3 |
| Contract Currency | $/sq m/year | USD/EUR | RUB |
| Minimum Lease Area | $/sq m/year | 5000 | 500 |

## 16 ▶ STOCK CLASS A (1”000 SQ M)




Source: Cushman & Wakefield

# Hospitality – Moscow hotels in Q1 2014

Average occupancy across all market segments of Moscow hotels in Q1 2014 remained almost unchanged (59%) as compared to the same period of 2013 (actual change comprised -0.3%). During Q1 2014 both Dollar and Rouble ADR (average daily rate) decreased (18% and 6% respectively). A 19% drop of RevPar (revenue per available room) nominated in US Dollars was registered as of March 2014 and amounted to 123 US Dollars. RevPar nominated in Roubles decreased by 4% only and comprised 4,324 Roubles.

The upscale segment demonstrated a negative trend compared to Q1 2013. Dollar RevPar dropped by 18% ($169), while RevPar nominated in Roubles – by 5% (5,939 Roubles). Such a result was reached by a 1% occupancy decrease (55%) and fall of ADR (17% and 5% in Dollars and Roubles rates), amounting to $340 or 10,644 Roubles respectively.

Business hotels did not show better results in January – March 2014. Thus, US Dollar RevPar decreased by 22% ($108) which was composed of a slight occupancy drop (3%) and a 18% fall of ADR nominated in US Dollars ($182). The Rouble RevPar decreased by 10% (3,795 Roubles) in line with a 5% ADR drop (6,373 Roubles).

ADR and RevPAR of midscale hotels also showed a decrease: both US Dollar and Rouble ADR demonstrated a negative trend (-21% and -9% respectively) amounting to $144 / 5,049 Roubles. As a result, RevPAR showed a decline of 17% in US Dollars ($92) and a 4% in Roubles

We expect the following hotels to open in 2014:

### 17 ▶ MOSCOW HOTELS OPENED IN Q1 2014

| Name | Room number | Address | Class |
|---|---|---|---|
| **Moscow** | | | |
| Raikin Plaza | 54 | Sheremetievskaya Street, 6/1 | 4 stars |
| Intourist Kolomenskoe | 259 | Kashirskoe Highway, 39Б | 4 stars |
| Azimut Moscow Olympic (former Renaissance Moscow Olympic) - rebranding | 486 | Olympiyskiy Avenue, 18/1 | 4 stars |
| **Moscow Region** | | | |
| Hilton Garden Inn New Riga | 164 | Novorizhskoe highway, Kostrovo village | 3 stars |
| Heliopark Lesnoy (former Marco Polo Lesnoy) - rebranding | 137 | Solnechnogorskiy area, Peshki village | 3 stars |

Source: EY database, open sources, operators' data

### 18 ▶ FUTURE HOTELS ANNOUNCED FOR OPENING IN MOSCOW AND MOSCOW REGION IN 2014

| Name | Room number | Address | Class |
|---|---|---|---|
| Four Seasons Hotel Moscow | 180 | Okhotny Ryad Street, 2 | luxury |
| Astrum Hotel Shelkovo | 184 | Shelkovo, Promenade Serafima Sarovskogo, 2 | 5 stars |
| Moscow Marriott Novy Arbat Hotel | 230 | Novy Arbat, 32 | 5 stars |
| Four Elements Borodino Club | 160 | Minskoe Highway, 100 away from MKAD | 5 star |
| DoubleTree by Hilton Moscow Leningradsky Riverside | 270 | Leningradskoye Highway, 39/7 | 4 stars |
| Radisson Blu Sheremetyevo Airport | 379 | Sheremetyevo Airport | 3 stars |
| Mercure Moscow Baumanskaya | 44 | Baumanskaya Street, 54/1 | 3 stars |
| Holiday Inn Crocus City | 1000 | Crocus City Expo | 3 stars |
| Ibis Stupino | 120 | Stupino, Pobedy Avenue | 2 stars |

Source: EY database, open sources, operators' data

(3,239 Roubles). The overall occupancy demonstrated a slight 3% increase comprising 63%.

It is necessary to point out that the strong fluctuations of the US Dollar against the Rouble had a significant impact on further declines in the Dollar equivalent. While the US Dollar in Q1 2014 went up against the Rouble by 14%, the Dollar figures showed a stronger decline than the Rouble.

An absolute gap in RevPar between market segments has changed and demonstrated the following results:

- The variation between the upscale and midscale segments comprised 77 US Dollars / 2,700 Roubles compared to 95 US Dollars / 2,910 Roubles in the same period of 2013.
- The difference in RevPar between upscale and business hotels slightly changed to 61 US Dollars / 2,144 Roubles vs. the Q1 2013 results (68 US Dollars / 2,079 Roubles). (**17** ▶)

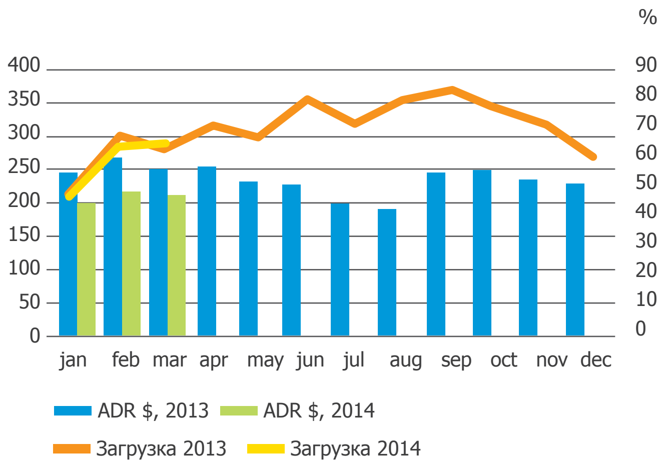
- A new Raikin Plaza hotel opened in Moscow on Sheremetievskaya Street, 6/1 in the end of January 2014. The 54-room hotel offers a restaurant, a lobby bar, a conference room, a gym, a beauty salon and underground parking.

- A 4-star Intourist Kolomenskoe business hotel opened in March 2014 on Kashirskoe Highway, 39Б. The hotel offers 259 rooms, a restaurant, four conference halls for 170 people, ground and underground parking.
- Renaissance Moscow Olympic Hotel which was under Marriott management until mid-December 2013 is now being managed by the Russian hotel operator Azimut Hotels. Azimut Moscow Olympic Hotel opened in Moscow on Olympiyskiy Avenue, 18/1, in the end of April 2014. A 4-star hotel offers 486 rooms, seven restaurants, a bar, 16 conference halls, a business center, a banquet hall, a fitness center and parking.

- A new Hilton Garden Inn Moscow New Riga hotel opened at the end of March 2014 in Kostrovo village, 50 km away from MKAD on Novorizhskoe Highway. The hotel offers 164 rooms, a restaurant, seven meeting rooms, a business center, a fitness center, sports and children's playgrounds and a summerhouse with BBQ.

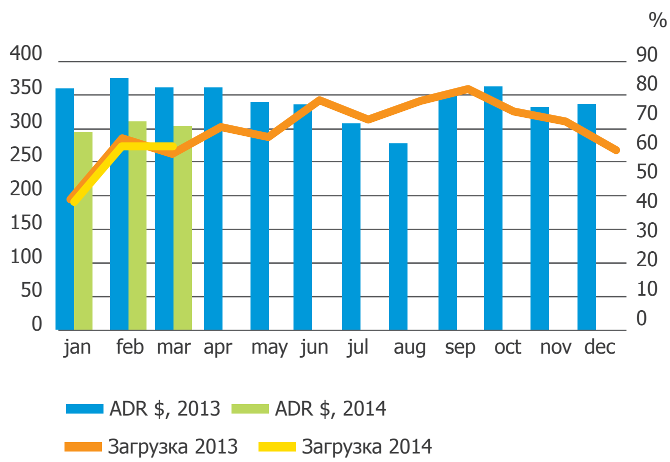
- A hotel, known as Marco Polo Lesnoy, started to operate under Heliopark Hotels & Resorts operator in the beginning of April 2014. Heliopark Lesnoy is located in Solnechnogorskiy area, Peshki village. The hotel offers 137 rooms, restaurants, conference-halls, a swimming pool, a sports ground and parking. (**18, 19, 20, 21, 22, 23** ▶)

**19 ▶ AVERAGE MARKET ADR ($) AND OCCUPANCY DYNAMICS, 2014 VS. 2013**



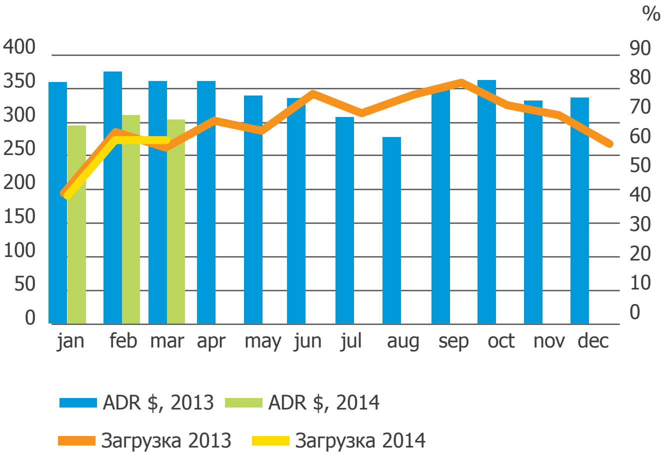

Source: EY

**20 ▶ 5-STAR HOTELS: ADR ($) AND OCCUPANCY DYNAMICS, 2014 VS. 2013**



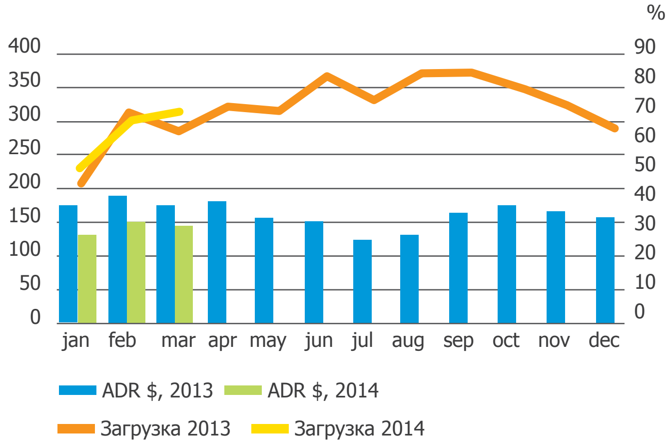

Source: EY

## 21 ▶ 4-STAR HOTELS: ADR ($) AND OCCUPANCY DYNAMICS, 2014 VS. 2013




Source: EY

## 22 ▶ 3-STAR HOTELS: ADR ($) AND OCCUPANCY DYNAMICS, 2014 VS. 2013




Source: EY

## 23 ▶ OPERATIONAL INDICES DYNAMICS

| | January - March 2014 | January - March 2013 | 2013 | January - March 2014 / January – March 2013, % |
|---|---|---|---|---|
| **5 stars** | | | | |
| Occupancy | 55% | 56% | 68% | -1% |
| Average daily rate (ADR) | 304 $ / 10,644 RUB | 367 $ / 11,158 RUB | 343 $ | -17 % / -5 % |
| Revenue per available room (RevPAR) | 169 $ / 5,939 RUB | 206 $ / 6,277 RUB | 231 $ | -18 % / -5 % |
| **4 stars** | | | | |
| Occupancy | 59% | 62% | 71% | -3% |
| ADR | 182 $ / 6,373 RUB | 221 $ / 6,725 RUB | 205 $ | -18 % / -5 % |
| RevPAR | 108 $ / 3,795 RUB | 138 $ / 4,198 RUB | 145 $ | -22 % / -10 % |
| **3 stars** | | | | |
| Occupancy | 63% | 61% | 73% | 3% |
| ADR | 144 $ / 5,049 RUB | 181 $ / 5,519 RUB | 164 $ | -21 % / -9 % |
| RevPAR | 92 $ / 3,239 RUB | 111 $ / 3,367 RUB | 118 $ | -17 % / -4 % |
| **Average** | | | | |
| Occupancy | 59% | 60% | 70% | 0% |
| ADR | 210 $ / 7,355 RUB | 256 $ / 7,801 RUB | 237 $ | -18 % / -6 % |
| RevPAR | 123 $ / 4,324 RUB | 152 $ / 4,501 RUB | 165 $ | -19 % / -4 % |

Source: Smith Travel Research, EY

# Hospitality – international Hotel Operators

Today, most major international hotel operators that provide both direct hotel management and franchising services are present on the Russian market. However, the total number of facilities operated under the brands of international operators is still extremely small: at present only 107 out of 9,316 hotels in Russia are part of international chains. Including announced projects, 258 facilities will be operating on the market by 2019. The leaders on the Russian market remain such chains as Carlson Rezidor Hotel Group, Accor Hotels, InterContinental Hotel Group and Marriott International. Carlson Rezidor Hotel Group remains the market leader, with a total of 25 operating hotels with 7,720 rooms in its portfolio at the end of 2013. As at 1 January 2014, Accor Hotels manages 19 hotels with 3,788 rooms in Russia. Company management is pursuing the aggressive development strategy announced last year, and plans to open 45 branded hotels with 7,942 rooms over the next five years. (**24 ▶**)

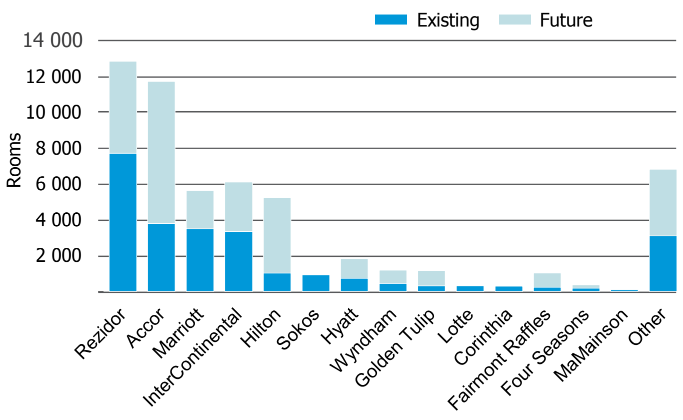
Moscow and Saint Petersburg remain the leaders in Russia in terms of room stock and the number of hotel facilities. However, after the country won the right to hold such major international events as the Olympics and the World Cup, the issue of developing hotel infrastructure became one of the most pressing.

The existing room stock of regional cities significantly outstrips market demand and the requirements of the international companies organizing the events. However, a significant portion of the supply available on the market does not meet international quality standards. (**25 ▶**)

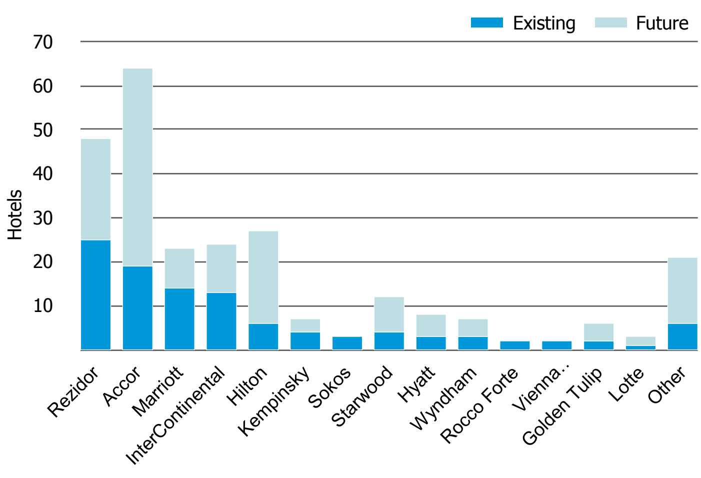
Since these events will be held in a wide number of locations throughout the country, international operators are concentrating their efforts on the cities where these events will be held, namely Sochi (8.7% of future supply), Rostov-on-Don (4.7%) and Nizhny Novgorod (3.3%). International brand name hotels are opening in some regional cities such as Rostov-on-Don, Yaroslavl, Kaluga, Voronezh and others for the first time. (**26 ▶**)

An important difference between the plans for expansion of operators in Moscow and Saint Petersburg and in regional cities is the difference in the star-rating of the hotels to be built. Most of the consumers of hotel services in the regions are Russian companies, which still look first and foremost at the hotel's pricing policy when choosing a place of stay for their employees. This trend has a positive effect on the rate of development of the regions, since the construction of three-star hotels is much less expensive than the construction of luxury hotels.

**24 ▶ RATING OF INTERNATIONAL OPERATORS WITH A PRESENCE ON THE RUSSIAN MARKET**

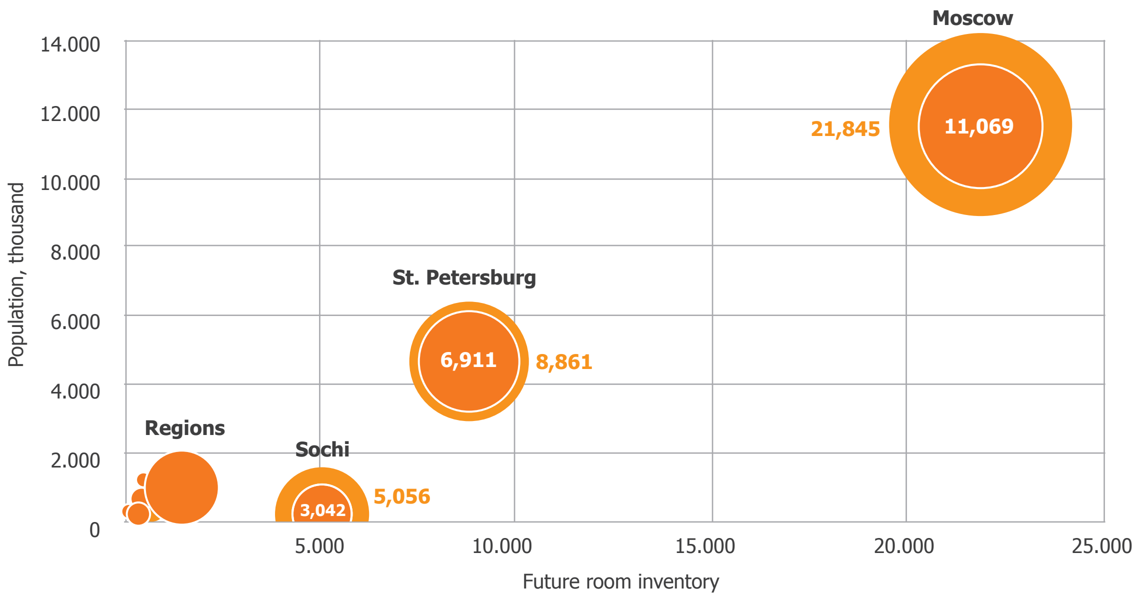



Source: KPMG



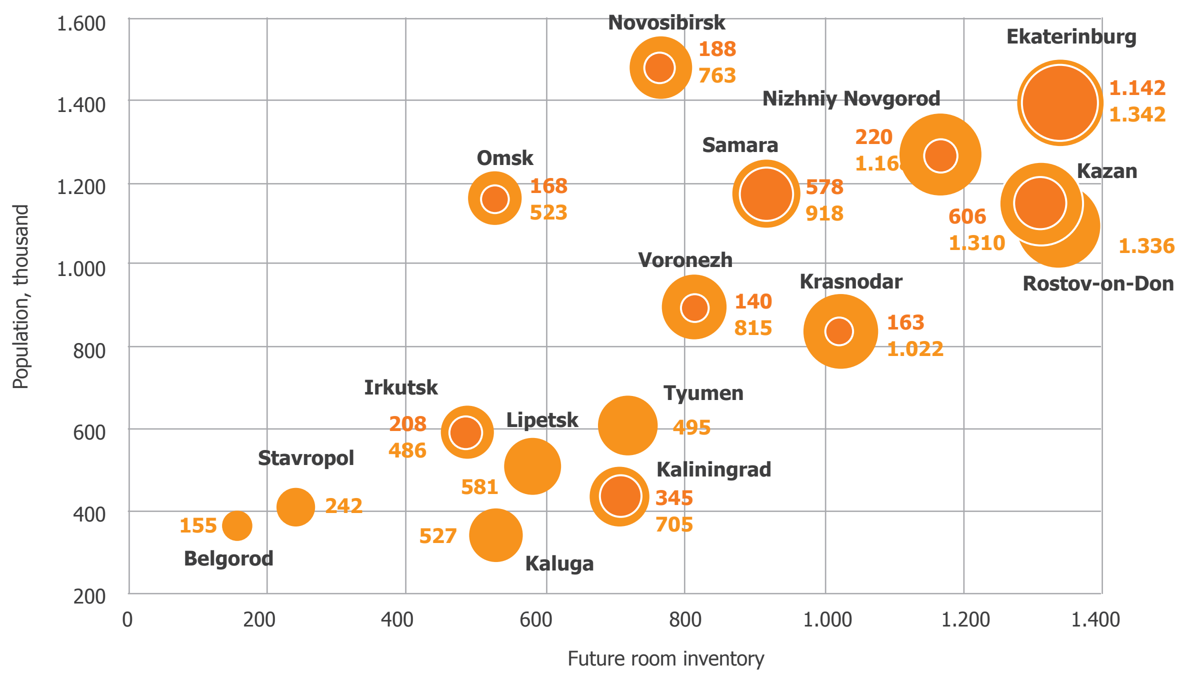

Source: KPMG

## 25 ▶ THE PRESENCE OF HOTEL OPERATORS IN RUSSIA




Source: KPMG analysis

## 26 ▶ THE PRESENCE OF HOTEL OPERATORS IN REGIONS



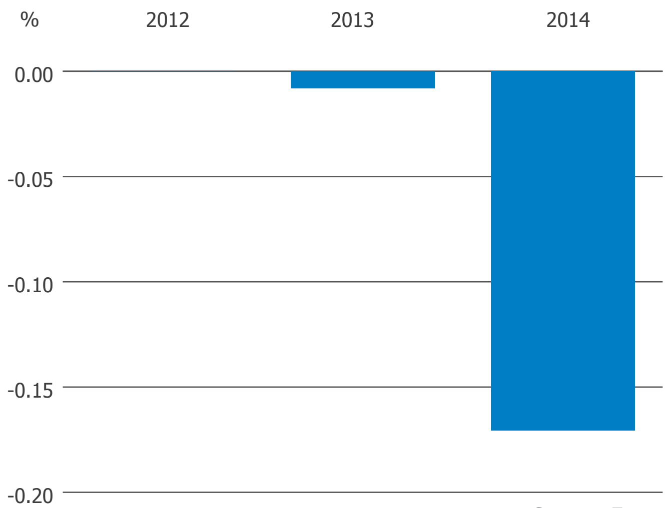

Source: KPMG analysis

# Residential

## OVERVIEW

The first quarter of 2014 showed a further decline in demand for high-quality rentals when compared to the same period of 2012 and 2013. The decline amounted to 17% when comparing Q1 2014 to 2013. While general decline in the number of foreign employees can account for the steady decline of demand over the years, the political and economical instability of the first quarter, in our opinion, accounted for the unexpectedly sharp decline this year. (27 ▶)

### 27 ▶ DECLINE IN NUMBER OF REQUESTS WHEN COMPARED TO 2011



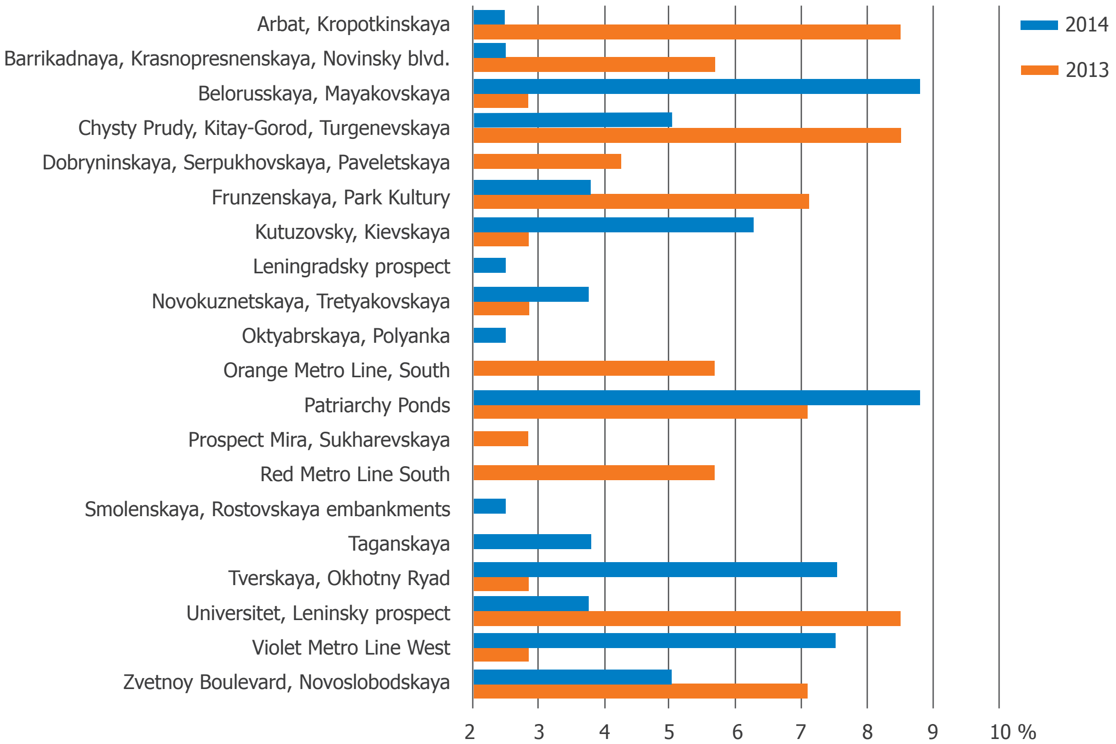

Source: Evans

## LOCATION

In the first 3 months of 2014 the most popular areas were "Belorusskaya/Mayakovskaya", and Patriarchy Ponds areas with over 17% of all rentals located there. This is a shift from the previous years. In the same period of 2013, the most popular areas were "Arbat, Kropotkinskaya" and "Chysty Prudy, Kitay-Gorod". Just like in previous year, however, the city center remains the most popular area to live with almost 70% of all rentals taking place in this area. (28 ▶)

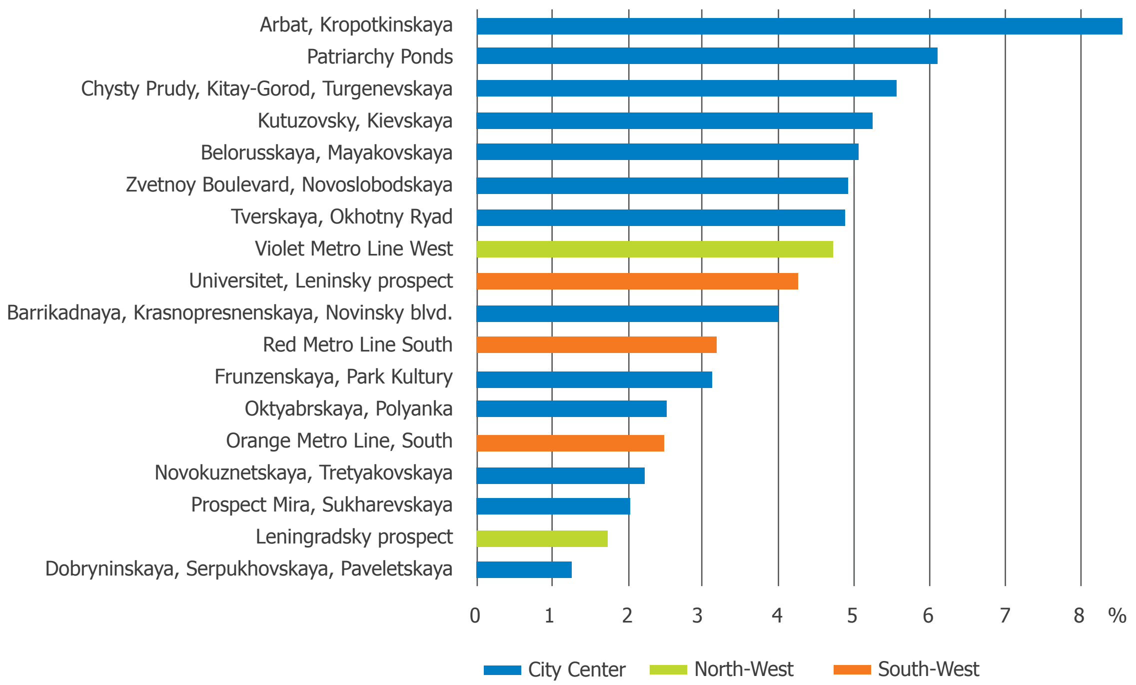
The largest supply of apartments is currently concentrated in the "Arbat / Kropotkinskaya" followed by "Patriarchy Ponds", "Chysty Prudy / Kitay-Gorod", and "Kutuzovsky / Kievskaya" areas. Outside of the city center the biggest supply is in the North-West and South-West areas of Moscow. (29 ▶)

### 28 ▶ SHARE OF ALL RENTAL REQUESTS BY AREA



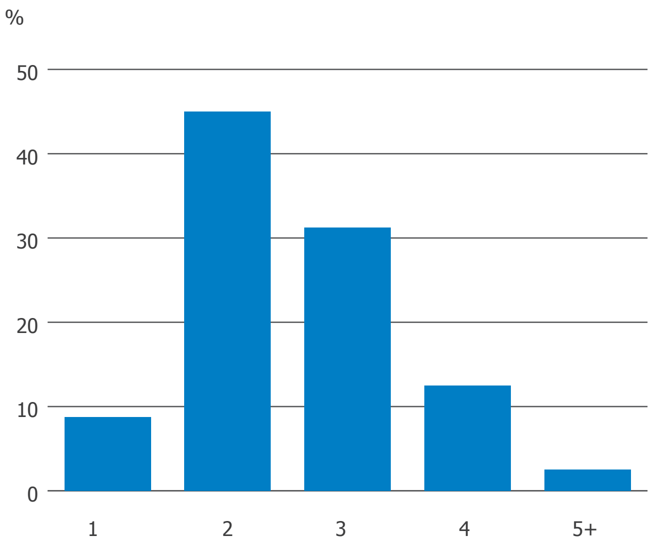

Source: Evans

## 29 ▶ SHARE OF ALL APARTMENTS OFFERED FOR RENT BY AREA



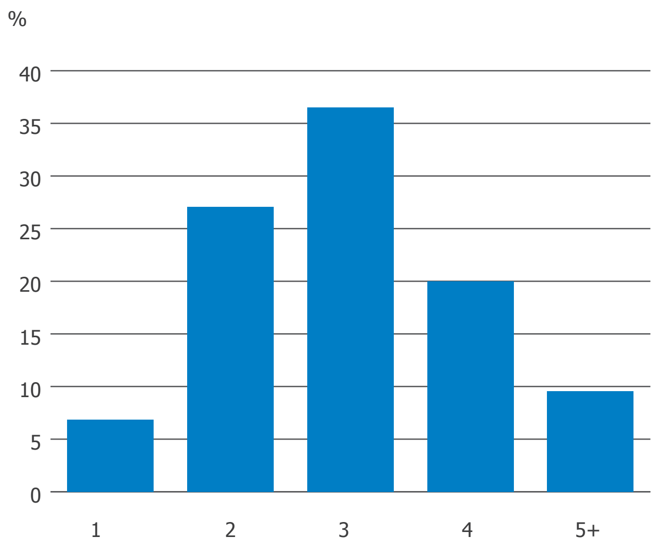

Source: Evans

## 30 ▶ SHARE OF ALL RENTAL REQUESTS BY NUMBER OF ROOMS




Source: Evans

## 31 ▶ SHARE OF ALL APARTMENTS OFFERED FOR RENT BY NUMBER OF ROOMS




Source: Evans

## APARTMENT SIZE

The biggest demand in the first quarter of 2014 was for apartments with 2 or 3 rooms (1 or 2 bedrooms) with almost 80% of all requests targeting these types of apartments. This indicates a further shift to smaller apartments when compared to the previous several years. This is most likely due to a reduction in housing budgets for many expatriate employees. (**30** ▶)

On the supply side, 2 and 3-room apartments make up the bulk of properties, but in reverse order. With 3-room apartments making up almost 37% and 2-room apartment making up over 27% of all properties currently listed. The supply of small, one-room, apartments fell to below 7% of the total number apartments on the market. This shows that the growth in supply of such apartments does not match the growth in demand. (**31** ▶)

## BUDGET

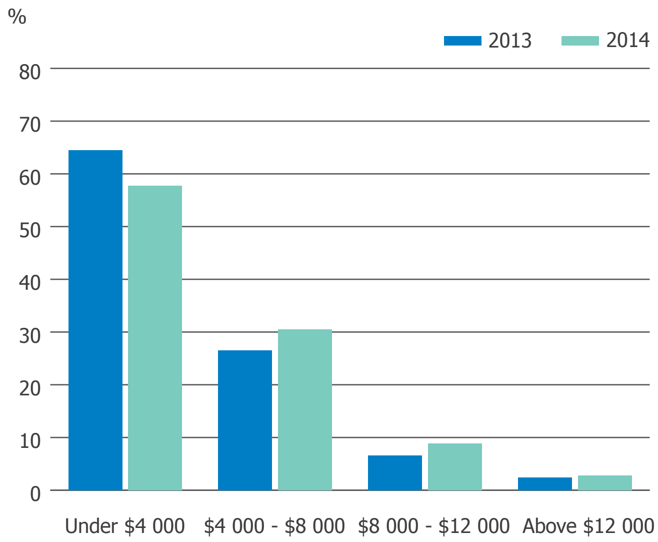
Overall, the average budget for all requests in the first quarter of 2014 was close to $4,000 per month. Most requests, over 65%, were under $4,000 per month. There was a shift to more requests for lower budget apartments when compared to the first three months of 2013. This is probably due to the fact that many companies continue to reduce budgets to reduce their overall personnel costs in the face of economic uncertainty. (**32** ▶)

Unlike in previous years, we have noticed an increase in the share of apartments offered for rent in the lower segment. Almost 45% of all apartments on the market in the first quarter were offered under $4,000 per month. This shows a shift in the landlords' expectations and understanding of the current economic situation. Another factor influencing the shift is the significant devaluation of the rouble, pushing the USD prices of some apartments into lower budget ranges. (**33** ▶)

## EXPECTATIONS

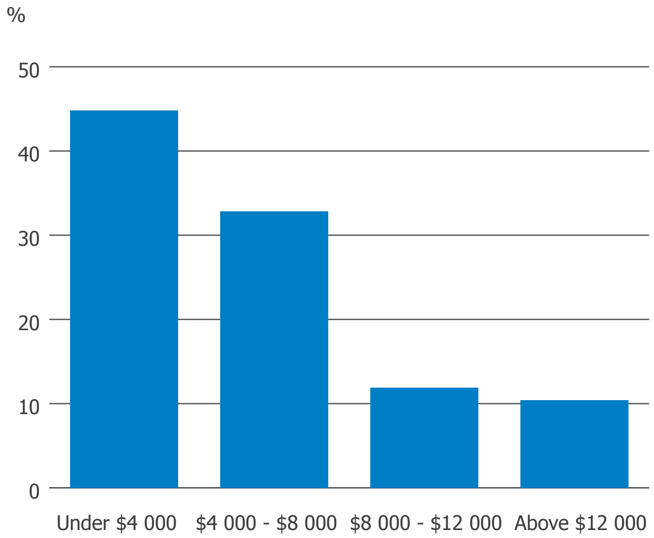
The demand for high-standard rentals in Moscow in the coming months will largely depend on the political and economic situation in the country. While overall the demand decline slightly due to the overall reduction in the number of foreigners working in Moscow, the decline may be sharp if the economic and/or political situation deteriorates further.

**32 ▶ SHARE ALL RENTAL REQUESTS BY BUDGET**




Source: Evans

**33 ▶ SHARE OF ALL APARTMENTS OFFERED FOR RENT BY BUDGET**




Source: Evans

**Hot Topic:**

# What investors should know about town-planning documents in Russia

**By Olga Ezhova**
**Associate, Dentons**

To successfully implement any construction project in Russia, the investor needs to have a clear idea of the documents determining the planning procedures and governing the development of the territory ("Town-Planning Documents"). However, constant changes in Russian legislation make it difficult for investors to keep up with the precise Town-Planning Documents necessary to study when planning construction, or their role. This article is intended to assist investors with this issue.

The most important Town-Planning Documents for investors assessing whether an investment project is possible on a land plot are the land use and development rules ("pravila zemlepolzovaniya i zastroyki", known as "PZZ"), and the general plan ("generalniy plan") of the town or village where the project is to be built.

## Role of the PZZ and general plan in analyzing whether construction is possible

To understand what information the investor can obtain from the general plan and PZZ, it is necessary to consider what these documents represent.

The general plan is a territorial planning document determining the purpose of territory within a town or village and its long-term development (20 years minimum). The general plan reflects the boundaries of settlements, established functional zones (public, business, industrial, etc.), and the city infrastructure facilities.

From a practical viewpoint, the information in the general plan allows an investor to determine which functional zone a land plot is in, and whether it is in a zone imposing restrictions on use (sanitary protection zones, water protection zones, cultural heritage conservation zones, etc.).

The PZZ are a town-planning zoning document determining the legal procedures for use of land plots by dividing a town/village into territorial zones (residential, public/business, industrial, etc.), and establishing town-planning rules ("gradostroitelniy reglament") for these zones. The PZZ answer the question of which land plots can be built on, which cannot, and what specifically can be built in a certain territory.

The investor can use the information in the PZZ to determine the current legal procedures for use of specific land plots and capital buildings, namely: the types of permitted use of land plots within a specific territorial zone (primary, conditional, and ancillary ones); restrictions on use and maximum dimensions of land plots; and restrictions on use and maximum dimensions of capital buildings.

The information contained in the general plan and the PZZ therefore allows the investor to decide:

1) whether construction on a specific land plot is possible at all, and
2) whether the parameters and functional purpose of the planned building conform to the legal procedures for the use of the land plot.

Below, we consider two practical questions frequently encountered by investors analyzing Town-Planning Documents for the purpose of subsequent construction in Russia:

1. What should be done when the information in the general plan and the PZZ is contradictory?
2. What should be done if the investment project does not conform to the PZZ and/or the general plan?

With respect to the first question, there are indeed cases where the information contained in the PZZ contradicts the information in the general plan. For example, a territorial zone provided in the PZZ may permit one kind of use of the land plot, while the functional zone provided in the general plan permits another use. What should the investor do, and which document has priority?

According to the law, PZZ are drawn up subject to the provisions of the general plan of the town/village. Inconsistency between the PZZ and the general plan is grounds for the head of the local administration to consider amendment of the PZZ, which may be initiated by any interested individual or legal entity. So, if during planning of the construction project the investor discovers that the PZZ are inconsistent with the general plan, it has the right to apply to the local administration for amendment of the PZZ to bring it into conformity with the general plan.

With respect to the second question, investors analyzing Town-Planning Documents often find that their planned construction does not meet the requirements of the PZZ and/or general plan. For example, a town-planning rule in the PZZ may not permit construction on the investor's land plot at all, or may permit construction of other kinds of facilities (for instance, a warehouse, but not a shopping center). Does the investor have any chance of implementing its project in this case?

Yes, it does. But only after the respective amendments are made to the PZZ and/or general plan. For this purpose, the investor must submit a proposal and justification to the local administration. The necessary amendments can only be made to the PZZ and/or general plan subject to the results of a public hearing on the issue.

## Consequences of having no approved PZZ or a general plan

Today, a fairly high percentage of the Town-Planning Documents have been prepared. Nevertheless, there are still territories in Russia in which the required PZZ and/or general plans have yet to be developed and approved. For example, PZZ have still not been approved in Moscow.

However, the law establishes certain adverse consequences directly affecting the interests of developers and investors in the event that the Town-Planning Documents are not approved.

Thus, upon expiration of the deadline established by the law, it is prohibited to allocate state and municipal land plots for construction, or to issue construction permits, absent approved PZZ. Therefore, if an investor plans to build in a certain territory for which PZZ are not approved by the established deadline, it will be able neither to acquire rights to the land plot for construction, nor to obtain a construction permit for the land plot it already has (until the respective PZZ are approved). I.e., the investor will effectively be unable to implement its project.

The deadline for these consequences has been moved back repeatedly, and in the latest amendments the deadline for Moscow and Moscow Oblast was extended until December 31, 2014. For municipal districts, for towns and urban districts, and for villages the extended deadline has already passed (June 30, 2013, December 31, 2013, and June 1, 2014 respectively).

As for the adverse consequences of not having a general plan of the town/village, absent this document the respective authorities cannot issue a decision transferring land from one category to another, which may be an obstacle to an investment project. I.e., even if the investor has rights to a land plot, absent the general plan for the town/village, the investor will not be able to implement a project that requires a change of land category. This rule will apply to Moscow and Moscow Oblast from December 31, 2014.

Therefore, when starting work on the business plan for implementing a construction project, the investor should first check whether the PZZ and general plan have been approved for the respective territory. The absence of these documents may mean that implementing the investment project on the said territory will face significant problems or even turn out impossible. At the same time, the investor will not be able to compel the local authorities to adopt the documents through court action, since the principle of separation of powers does not permit the judiciary to interfere with the activities of representative local authorities and the courts do not have the power to order the said bodies to adopt any regulatory act, including PZZ and general plans.

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