



Q1 2014
WAREHOUSE MARKET
REPORT
Moscow

HIGHLIGHTS

- In Q1 2014, the new supply stock amounted to 200 thousand sq m, which is 1.6 times more than for the same period in 2013.
- The volume of warehouse space lease and purchase transactions by end-users remains high. In Q1, this figure has reached 203 thousand sq m, which is 23% more than in Q1 2013.
- Since the end of 2013, the vacancy rate has slightly grown: to 2.5% for Class A in the Moscow region.
- Rapid growth of the dollar against the ruble, and the growth of supply stock in the northern and southeastern Moscow suburbia have led to a decline in the average asking lease rates down to 120–130 \$/sq m/year for Class A (triple net).

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"If one should take a look at the warehouse real estate market through the prism of statistical indicators: declining demand, growing vacancy rates, reduced lease rates – one will have a feeling that the market is going through hard times. However, the lessons taught by the recession of 2008–2009 have not been forgotten, and now many developers have implemented a number of measures to keep the interest of potential acquirers in their facilities steady. Political and economic events undoubtedly affect all commercial real estate markets: for the warehouse segment, the growth of the dollar and the euro has brought on a reduction of prices and lease rates in foreign currency, while general instability resulted in a slowing down of the negotiations processes for the purchase and lease of space. However, in general, the activity of individual projects still depends heavily on their local competitive advantages, and the whole 2014 will proceed under the "economy and efficiency" slogan."

Key events

The interest towards regional warehouse markets from both the tenants and the developers continues to grow. According to the statements made by the federal and local players, high-quality new speculative objects will be delivered in Yekaterinburg, Chelyabinsk, Ufa, Perm, Samara, Tolyatti, Krasnodar, Rostov-on-Don, Novosibirsk and Vladivostok over the two coming years.

- ♦ The transport and logistics complex Yujnouralsky is under construction in Chelyabinsk, its first stage will amount to 82 thousand sq m. The delivery is announced for 2015. The construction of the

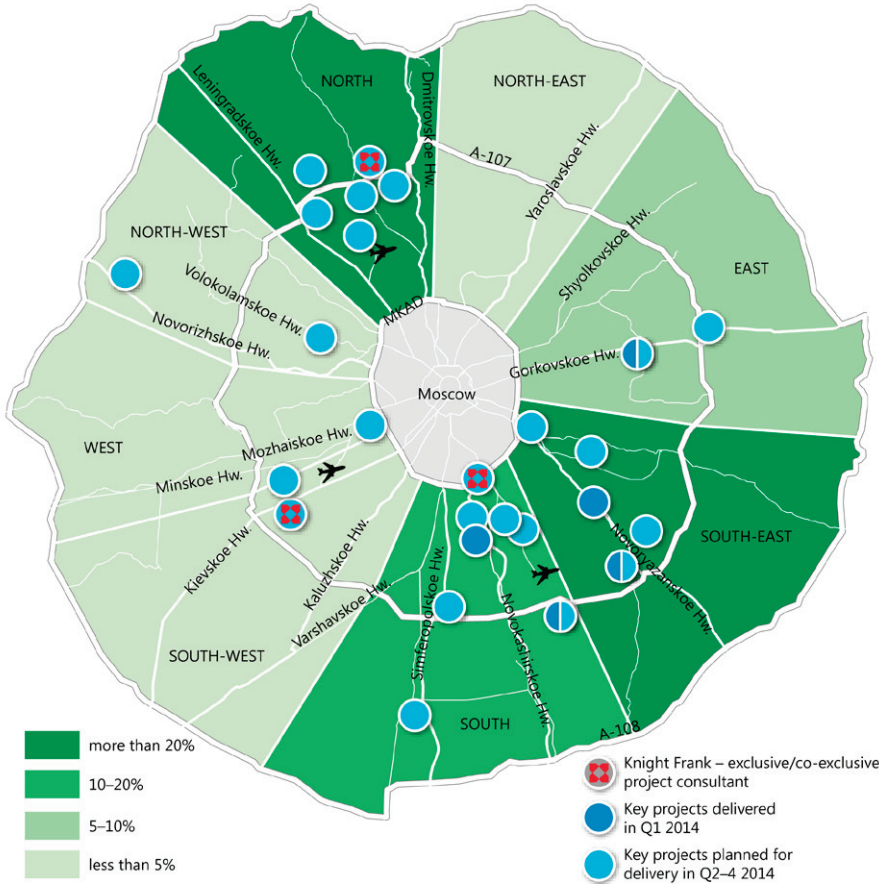
Key indicators. Dynamics

Indicator	Class A	Class B	Dynamics*
Total high-quality stock volume, thousand sq m	8,134		▲
including, thousand sq m	6,183 +3%	1,951 –	▲
Delivery volume in Q1 2014, thousand sq m	201		–
The expected growth of supply until the end of 2014, thousand sq m	900**		▲
Take-up volume in Q1 2014, thousand sq m	203		▲
Average vacancy rate, %	2.5	2.0	▲
Asking lease rates***, \$/sq m/year	120–130	100–110	▼
Operating expenses, \$/sq m/year	35–45	25–40	▶
Capitalization rate, %	11.0–11.5	11.0–12.0	▶

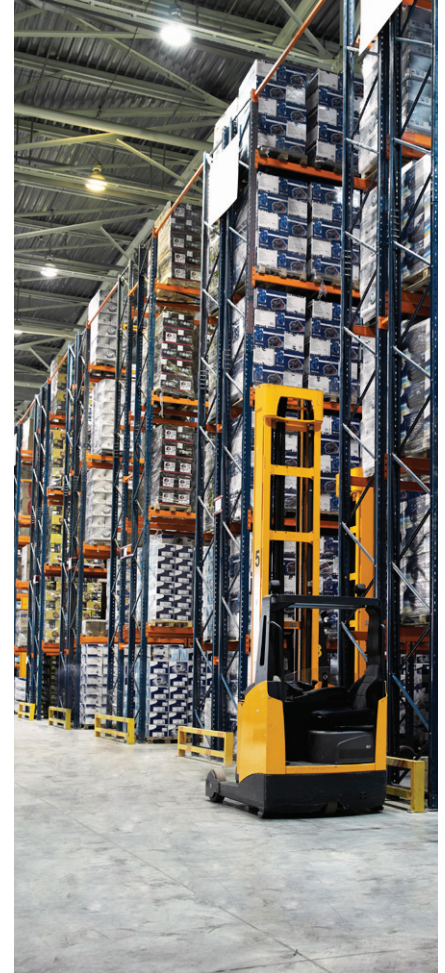
* Changes compared with the year-end 2013 figures
 ** Announced warehouse delivery volume is 1.7 million sq m, however, our evaluation suggest that it will not exceed 900 thousand sq m
 *** Triple net – excluding VAT, operating expenses and utility bills
 Source: Knight Frank Research, 2014



Geographic distribution of the total high-quality warehouse space take-up in Q1 2014



Source: Knight Frank Research, 2014



complex is expected to increase the attractiveness of the city as a transport and logistics hub and will entice distribution and manufacturing companies as warehouse tenants.

- PNK Group has announced the start of a warehouse complex construction in the second half of 2014 in Yekaterinburg; its total area will amount to 125 thousand sq m. Moreover, a2logistic company has announced the construction of a warehouse complex with an area of 118 thousand sq m.
- A major lease transaction was closed in Rostov-on-Don: X5 Retail Group Company is to occupy 30 thousand sq m in a warehouse complex that is being built by a2logistic. Knight Frank acted as the consultant of the transaction.
- Just like in the Moscow region, the main demand for high-quality warehouse space in the regional cities of the country is shaped by retailers. Major retail chains

such as X5 Retail Group, MediaMarkt and METRO Cash & Carry have announced plans of active expansion.

Supply

By the end of Q1 2014, the total supply of high-quality warehouse space in the Moscow region has exceeded 8 million sq m. About 200 thousand sq m of warehouse space were delivered in the first three months, which is 1.6 times higher than for the same period in 2013. This relatively high volume of new supply is largely a result of the delivery postponement for a number of objects from the end of the previous year.

In Q1 of this year, new warehouse facilities were built in the south, southeast and east of the Moscow region. The largest share (about 58%) of the new construction fell with the southeast direction (Novoryazanskoye highway): construction of several large complexes is underway there. Another

24% and 18% fall with the south and east respectively.

New facilities are being actively built in the north of the region (along the A-107 highway, between Leningradskoye and Dmitrovskoye highways), where about 735 thousand sq m of new class A warehouse space have been announced for delivery in 2014. According to our estimates, not all this space will actually be delivered, in fact, we expect a delivery of 500 thousand sq m.

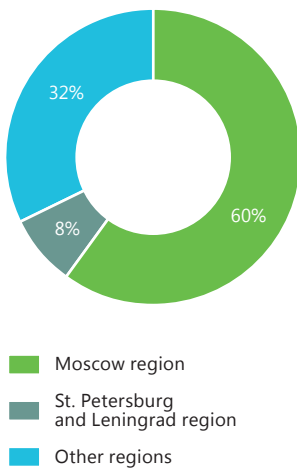
However, even the appearance of a half of the total announced amount over such a small territory will definitely lead to vacancy rates growth. We expect their figure to grow to 7-8% by the end of this year. By the end of Q1, the vacancy rate for Class A facilities has slightly increased to a value of 2.5% compared with 1.9% at the end of 2013.

Such an active warehouse development creates stronger competition for the tenant. As a result, in order to get the competitive

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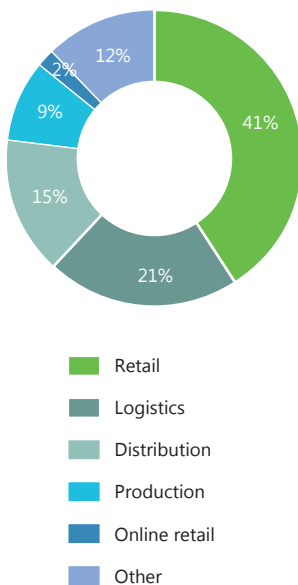
Moscow

Rapid take-up growth in the regional cities in Q1 resulted not only from the growth of interest in them, but in many ways occurred due to the fact that the lease agreements signed during this period are the ones for which negotiations have started back in 2013



Source: Knight Frank Research, 2014

Transactions volume distribution based on the business profile of warehouse tenants and buyers



Source: Knight Frank Research, 2014

advantage, the proprietors introduce new technological solutions to provide additional efficacy and safety of use for the building, as well as consider possible ways to increase the economic attractiveness of their sites.

Demand

The total lease and purchase transactions volume on the Russian market of high-quality warehouse property in Q1 2014 amounted to about 338 thousand sq m, which is the highest value over such period for the last 6 years and exceeds the Q1 2013 figure by 35%.

The main share of lease and purchase warehouse transactions, about 60%, still occur in the Moscow region. However, in Q1 2014, this value is slightly lower (by about 9 p.p.) than the average value of such periods of the past 3 years. This confirms the trend of growth in demand for warehouse space in the regional cities of Russia. For the first time in the history of Russian market, the share of high-quality warehouse transactions in the regions (excluding the Moscow region, St. Petersburg and Leningrad region) in Q1 has reached 32%.

At the same time, in absolute numbers the volume of transactions for the first three months is 2 times higher than in Q1 last year. The rest of the record low 8% of the total take-up fell with the market of St. Petersburg and Leningrad region, which was caused mainly not by insufficient demand, but by the shortage of available supply.

The share of purchase transactions in the total take-up volume of high-quality warehouse space in the Moscow region amounted to about 17% – almost 34 thousand sq m. This figure is 16% higher than for the same period last year. We expect a slowdown in the warehouse space purchase transactions in Q2, which will be caused by the unwillingness of the owners to make concessions of adjusting the price downward in dollar terms. It should be noted that the costs of importing construction materials are growing, while ensuring full import substitution is not yet possible without compromising the quality of the materials used. As a result, a reduction of prime construction cost can be achieved through either lowering the profitability of the project for the developer or reducing the quality of the constructed building. Potential buyers adjust plans to purchase warehouse space in anticipation of stabilization of the political and economic situation, although in some cases warehouse property continues to be regarded as a reliable asset for investment.

In terms of geographic distribution of demand in the Moscow region, about 66% of the total leased and purchased stock fall with the southern directions (southeast, south and southwest); in the north, where active development is underway, the figure is about 24%. The rest falls with the eastern direction (Gorkovskoye highway).

The retailers (online and offline, as well as distributors) share in the total volume of transactions remains the same: in Q1, it amounted to more than a half (almost 60%) of the total warehouse space take-up. Comparing to Q1 2013, the share of logistics operators has noticeably grown – by 17 p.p. However, despite this, their share in the total transactions volume by the end of 2014 is unlikely to exceed 20%.

Commercial terms

In Q1 2014, we observed correction of asking lease rates for Class A (triple net) to the range of 120–130 \$/sq m/year. Such a situation on the market is caused by the rise of dollar exchange value against the ruble to the recession level of 2009. It is interesting to note that due to the large amount of future supply in the north of the Moscow region, where about 43% of the total delivery volume has been announced, asking lease rates for some facilities in this direction were 115–120 \$/sq m/year in Q1.

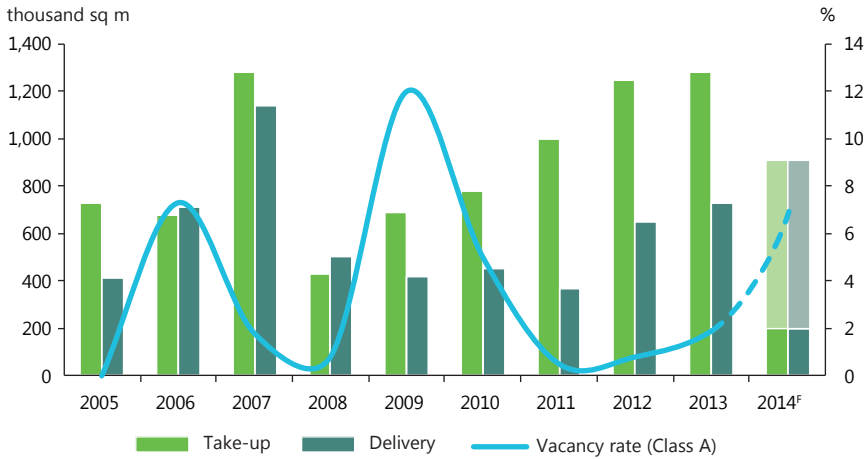
The number of lease contracts, where the rate is denominated in rubles, is not growing because warehouse complexes, as before, are mainly credited in foreign currency, and the transition to ruble loans is hindered, among other things, by the unwillingness of the tenants to accept the ruble indexation rate equaling Russian inflation.

Despite the growth of dollar exchange value, the average bid prices for objects on sale remained at the level of 2013, amounting to \$1,200–1,400 per sq m (excluding VAT) for Class A warehouses. As a reminder, this is caused by the unwillingness of proprietors to lower prices in dollar terms.

Forecast

About 1.7 million sq m of high-quality warehouse space have been announced for delivery in the Moscow region by the end of 2014. With about 64% of new announced stock falling to the northern and southeastern territories. However, taking into account possible downwards changes in future demand against the backdrop of some of the political and economic unrest, a correction

By the end of 2014, the new supply stock is expected to amount to no less than 900 thousand sq m, while the lease and purchase transactions volume to be in the range of 800–900 thousand sq m



Source: Knight Frank Research, 2014

of plans for the delivery of projects is likely to occur. According to our estimates, about 900 thousand sq m will be introduced, of which about a half will be delivered in the

northern direction of the Moscow region. Thus, the total warehouse supply stock of Class A and B in the Moscow region may reach 9 million sq m by the end of 2014.

Taking into account the fact that the largest volume of demand for high-quality warehouses is shaped by trade companies (online and offline commerce, distributors), for the past 3 years their share was about 60% on average, – further development of the Russian market of high-quality warehouse space will largely depend on the situation on the retail market. Following the rising prices of imported goods on the territory of the Russian Federation (due to the growth of foreign currency exchange rate); there is a probability of consumption decline with the population or a transition of demand to a low-price segment (which has happened during the recession of 2008–2009). This may cause a drop in demand for warehouse space with the commercial operators, including possible reduction of the amount of stored commodities. Considering the possible downward dynamics trend in demand, the take-up is expected to be in the range of 800–900 thousand sq m by the end of 2014.

Based on the results of Q1 2014, in the absence of major macroeconomic shocks, the asking lease rates for Class A warehouse space will likely remain at 120–130 \$/sq m/year.



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