RESEARCH

H1 2016

OFFICE MARKET REPORT

Moscow

HIGHLIGHTS

Class A and B new delivery volume has dropped by 20% compared to H1 2015.

Class A and B vacant office space volume is 2.8 million sq m.

Take-up volume in H1 2016 has increased by 25% compared to H1 2015 in Class A offices and by 33% in Class B offices.

OFFICE MARKET REPORT MOSCOW

Konstantin Losiukov
Director, Office Department
Knight Frank

"Moscow office real estate market turned positive showing signs of stabilization after continuous fall. These signals found expression in the reduction of vacant space and slowdown of rental rate decline. However, the prospects of recovery are still uncertain, the process itself may last a long while. The achieved balance is the result of several major transactions, while most companies still follow the optimization strategy.

Today, it is still more of a tenant's market offering a wide range of options and attractive lease terms. Nevertheless, there are examples when landlords are beginning to slightly raise asking rates after letting part of their premises. The reason for this is expected reduction in the volume of new construction in 2017–2018. Then, there may be a decrease of options available for lease and purchase thus stimulating rental rates increase".

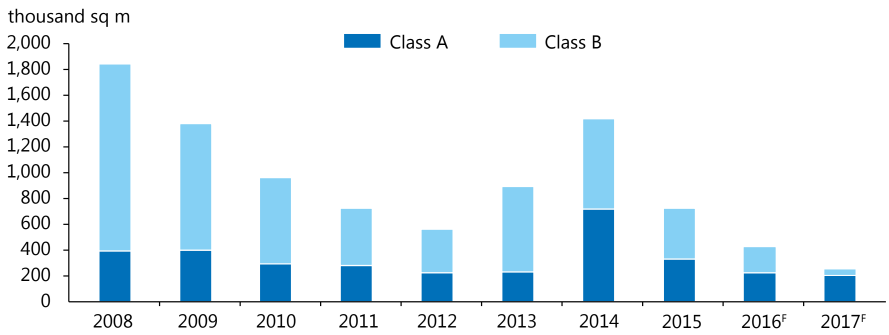
Key indicators. Dynamics*

		Class A	Class B
Total stock, thousand sq m		15,714	
including, thousand sq m		3,851	11,863
Delivered in H1 2016, thousand sq m		175	
including, thousand sq m		30	145
Net take-up, thousand sq m		233	
including, thousand sq m		168	65
Vacancy rate, %		20.5 (-3.9 p. p.)*	17.0 (-0.5 p. p.)*
Average weighed asking rental rate**	USD/sq m/year	465 (-1.9%)*	262 (-8.1%)*
	RUR/sq m/year	24,662 (-1.9%)*	13,899 (-8.0%)*
Rental rates range**	USD/sq m/year	280–850	250–650
	RUR/sq m/year	10,000–45,000	7,500–35,000
OPEX rate range***, RUR/sq m/year		4,000–7,500	2,500–4,500

* Compared to Q4 2015
** Excluding operational expenses utility bills and VAT (18%)
*** OPEX rate does not consider change related to property tax rate increase

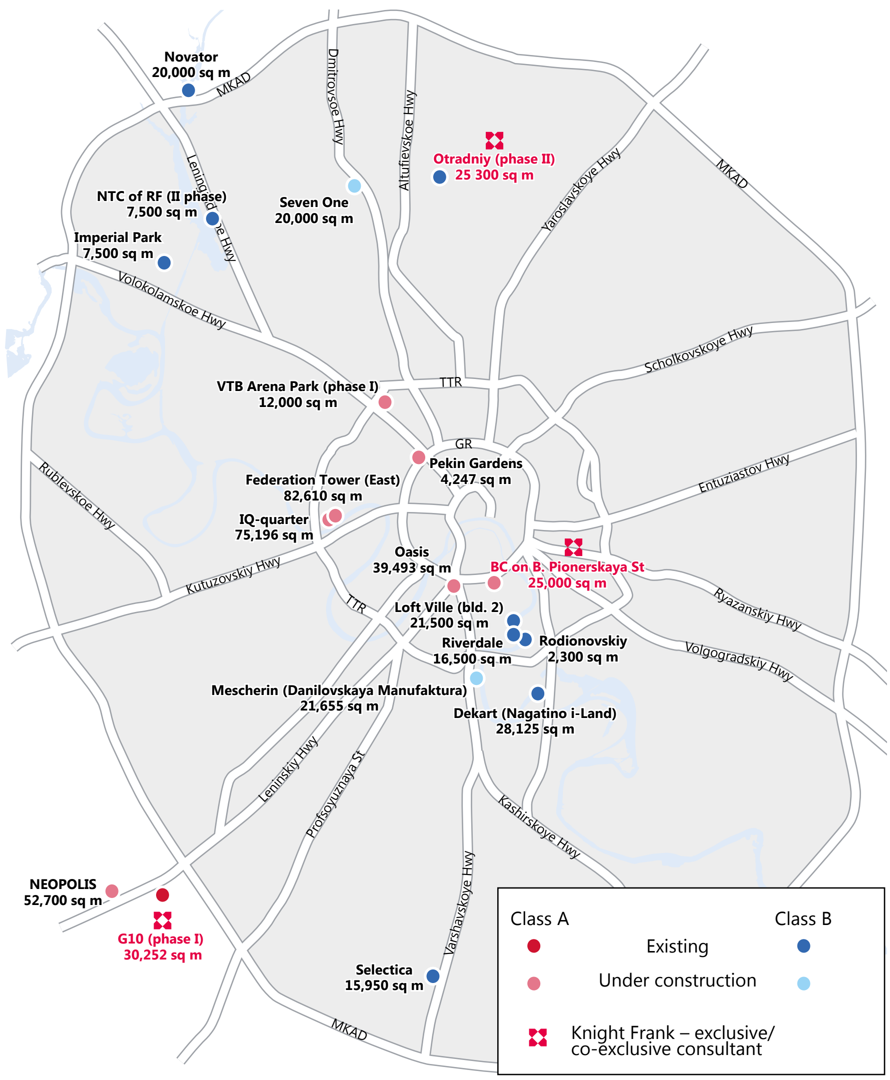
Source: Knight Frank Research, 2016

New delivery volume dynamics for Class A and B offices



Source: Knight Frank Research, 2016

Key office projects delivered in H1 2016* and due to be commissioned in H2 2016

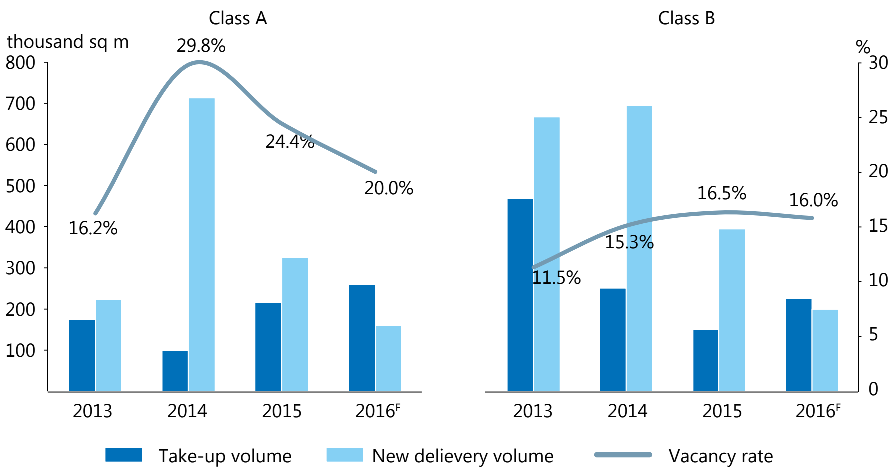


* Office properties that received the delivery act in H1 2016

The building class is indicated according to the Moscow Research Forum Office Classification of 2013

Source: Knight Frank Research, 2016

Dynamics of new delivery, take-up and vacancy rates of Class A and B offices



Source: Knight Frank Research, 2016

Supply

The total stock of Moscow office premises has reached 15.7 million sq m referring 25% to Class A and 75% to Class B office buildings.

Developers have postponed construction start of a number of office buildings since 2014: part of the projects are still at the design stage, other concepts have been revised. As a result, landlords have reduced office component or completely rejected it. The delivery volume of H1 2016 has become a record low equaling to 175 thousand sq m.

The vacancy rate of Class A was registered at the level of 20.5% and 17% in Class B. Class A index shrank 3.9 p. p. owing to completion of several large transactions along with insignificant delivery volume. An important event influencing the vacancy rate dynamics became the transfer of ownership of one of the office buildings to the lending bank. There is some evidence that it may accommodate some of its subsidiaries in this building. Thus, the building was withdrawn from the market.

Despite this, today Moscow office market comprises 2.8 million sq m available for tenants and buyers in delivered office buildings, and about 3 million sq m including buildings in active construction stage.

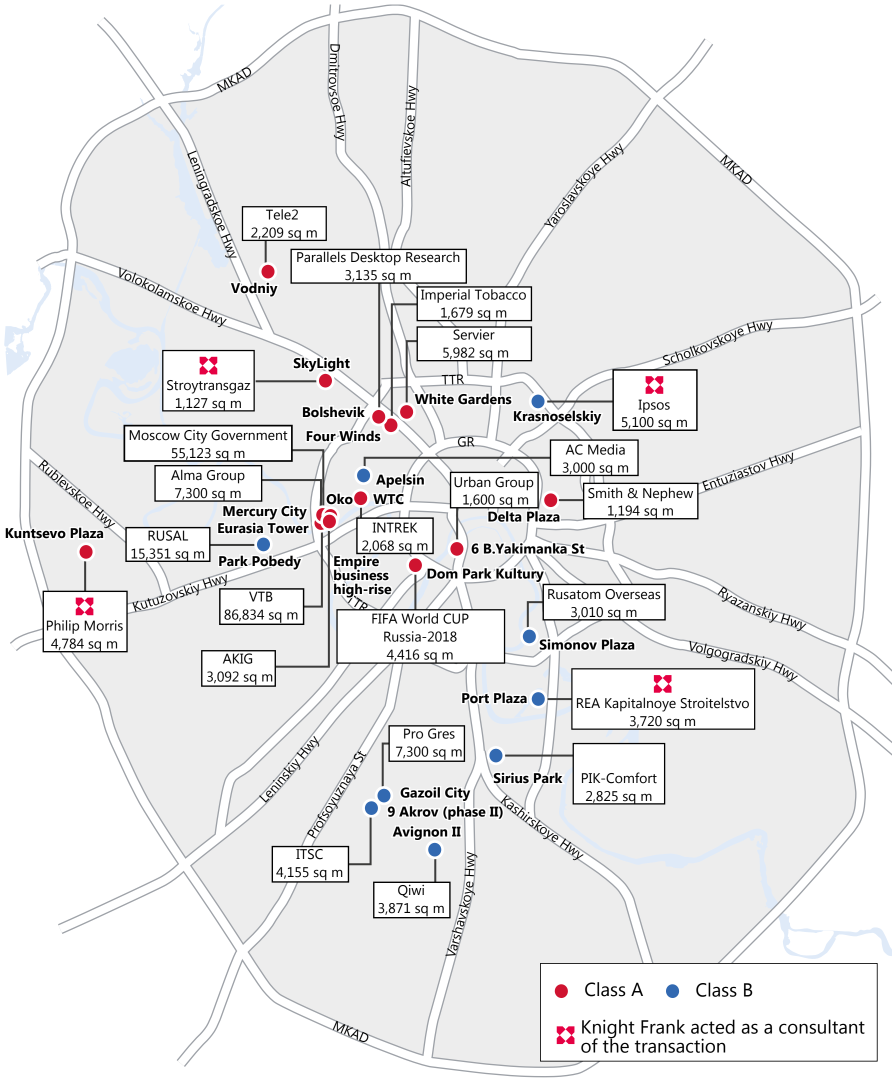
Demand

The net take-up in Class A and B offices has totaled 233 thousand sq m, which is 25% higher against first six months of the previous year if excluding the largest Q1 2016 transaction (transfer of ownership rights for the business centre (85 thousand sq m) to VTB Group against loan debt). The average transaction size increased 1.6 times and reached 1.5 thousand sq m, while the average size of lease transaction has not change.

The share of lease renegotiations in the total volume of transactions in H1 2016 was 59% against 73% for the same period of the previous year. There are less revisions of lease agreements in order to reduce the risks of ruble exchange rate fluctuations: today we witness an increase in the number of extensions of agreements when the parties extend them close to the expiration of the lease term or due to the break option, agreeing lease terms at the current market rental rates.

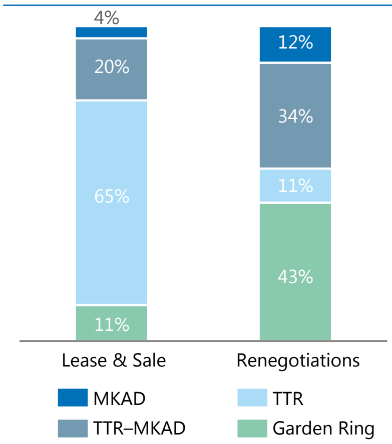
The tenant mix structure is mainly formed by several large transactions of Q1 2016, therefore the breakdown has remained unchanged. The largest share of 32% was taken by financial sector companies as a result of the transfer of ownership rights for Eurasia Tower to VTB Group. The share of non-profit organizations was 22% due to the purchase of 55 thousand sq m of office space in MFC OKO by Moscow City Government. Another landmark transaction was the acquisition of 15 thousand sq m of office space in Park Pobedy business centre by RUSAL company. Thus, the share of the manufacturing sector in the total volume of transactions has amounted to 11%.

Key lease and purchase transactions closed in H1 2016



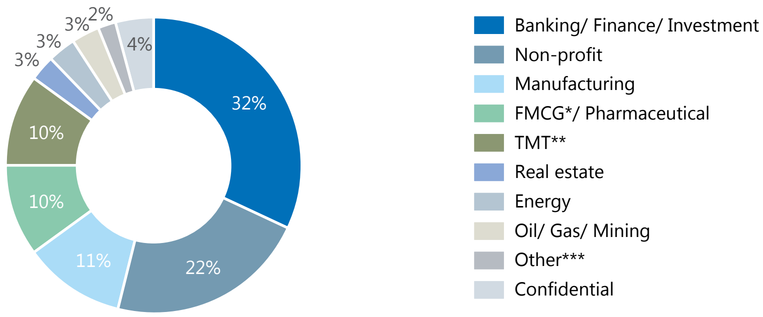
Source: Knight Frank Research, 2016

Distribution of transactions by type and location



Source: Knight Frank Research, 2016

Tenant mix



* Fast moving consumer goods

** Technology, media and telecommunications

*** B2B: consulting, legal services/ Transport and Logistic

Source: Knight Frank Research, 2016

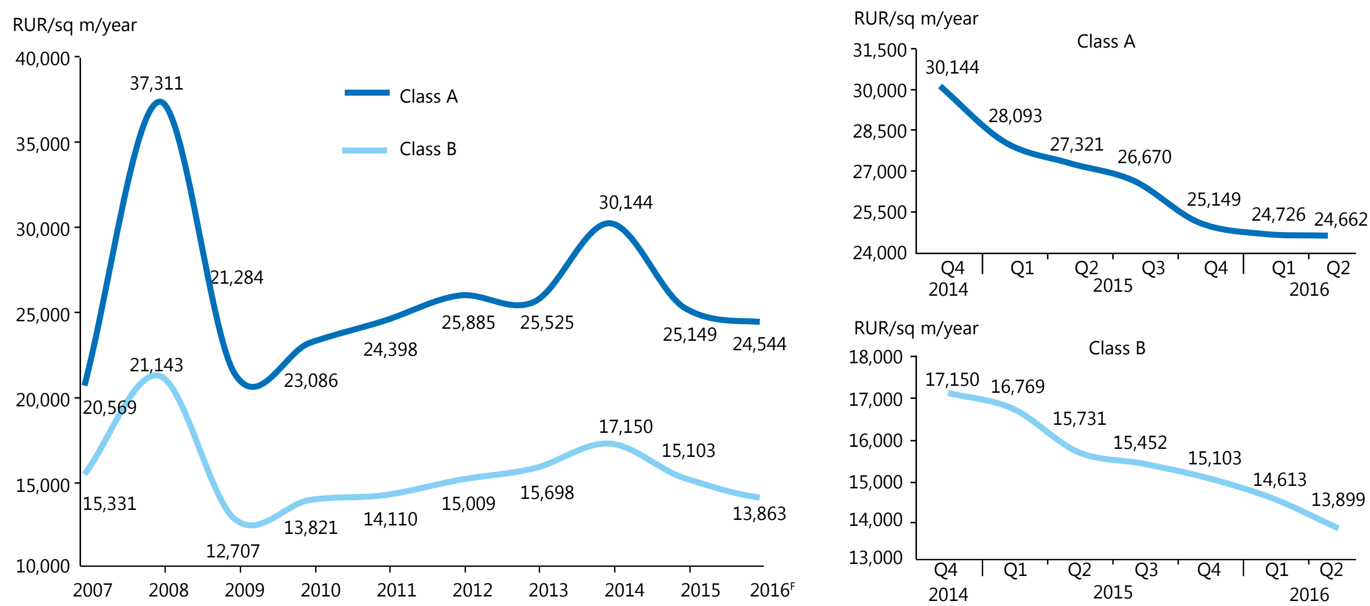
The largest number of lease and purchase transactions was recorded in facilities located near the Third Transport Ring (65%). This was due to two major transactions with the total volume of more than 140 thousand sq m in Moscow City business district. Interestingly, the demand for decentralized offices has been falling since the middle of 2015: the share of lease and purchase transactions of office space located in the vicinity of the Moscow Ring Road slumped from 21% to 4%. Today, there is still office space available in the developed business districts in the city centre on rental rates comparable to the rates in the business centres in remote areas.

Commercial terms

Class A rents denominated in russian rubles remained almost unchanged and amounted to 24,662 RUR/sq m/year and Class B rents were 4.9% down equaling to 13,899 RUR/sq m/year. Class A and B USD rental rates have reached the level of 465 and 262 correspondingly.

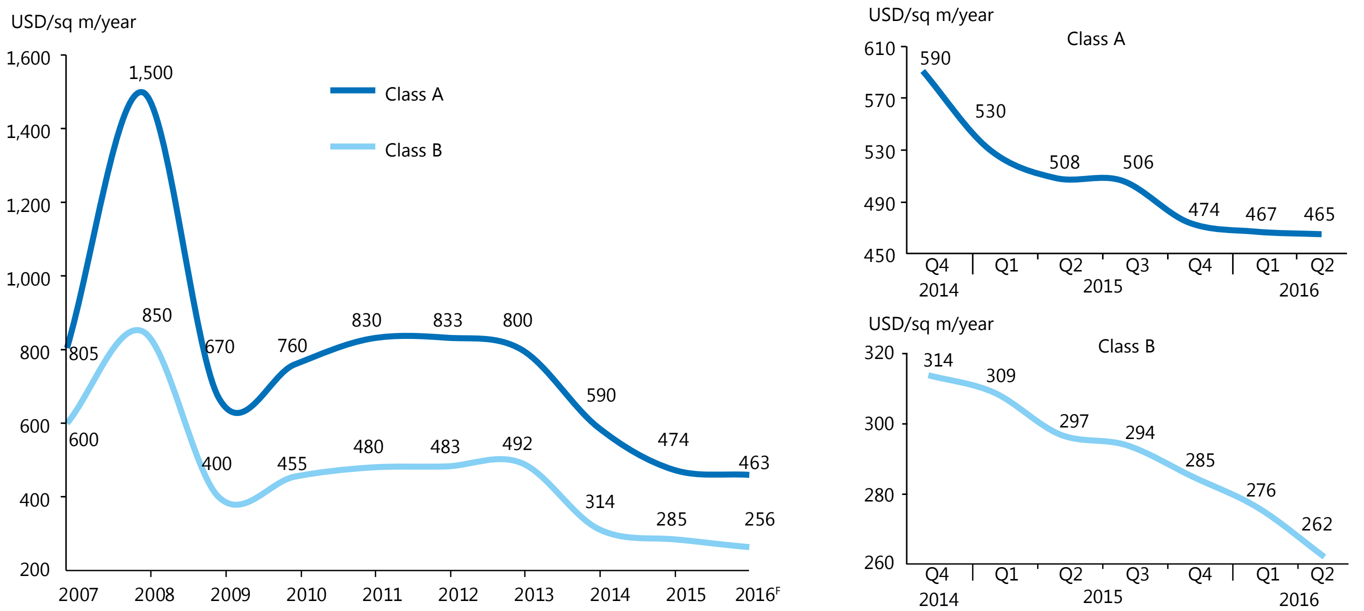
Sustained rental rates decline of started from mid 2014 has slowed down today. The current downward trend is determined by the strategy of separate landlords, who were late adapting to a highly competitive market and, therefore, the level of vacant space in their facilities is quite high. Thus, another historical anti-record has been updated in the office real estate market of Moscow.

Average asking rental rates dynamics for Class A and B offices denominated in RUR



Source: Knight Frank Research, 2016

Average asking rental rates dynamics for Class A and B offices denominated in USD



Source: Knight Frank Research, 2016

Moscow submarket data. Key indicators

Submarket		Lease area, thousand sq m	Class A Average rental rates USD/sq m/year		Class A Average rental rates RUR/sq m/year		Class A Vacancy rate, %		Class B Average rental rates USD/sq m/year		Class B Average rental rates RUR/sq m/year		Class B Vacancy rate, %	
Boulevard Ring	Central business district	712	907		48,090		16.8		404		21,386		11.5	
Garden Ring	South	918	476	532	25,215	28,208	21.3	17.0	507	432	26,875	24,298	16.3	12.1
	West	273	746		39,515		21.1		–		22,405		10.6	
	North	660	–		26,885		8.7		–		25,144		11.3	
	East	401	521		26,818		23.1		328		17,392		15.8	
Third Transport Ring	Khamovniki	260	780	561	41,317	29,720	16.8	19.0	–	281	23,676	14,927	6.0	17.6
	Leninskiy	278	–		–		–		–		15,998		20.6	
	Tulskiy	959	–		–		–		–		13,852		17.5	
	Kievskiy	424	–		29,661		10.0		–		14,050		55.9	
	Presnenskiy	357	528		27,962		6.8		–		19,187		15.4	
	Prospekt Mira	162	–		–		–		–		17,823		25.6	
	Tverskoy-Novoslobodskiy	752	648		34,331		19.8		359		19,010		12.0	
	Basmanniy	532	–		–		–		–		15,751		7.8	
	Taganskiy	234	–		–		–		232		12,297		14.5	
	Volgogradskiy	434	–		20,399		62.7		285		15,094		24.2	
	MIBC Moscow-City	913	535		28,352		20.2		–		–		–	
TTR–MKAD	North	627	–	363	25,000	19,265	6.7	20.0	–	252	12,564	13,340	14.2	15.9
	Northwest	692	460		24,362		11.0		–		14,692		17.0	
	South	1,149	–		18,222		–		–		9,555		16.6	
	West	550	–		26,860		–		327		17,323		17.8	
	Southwest	585	342		18,103		38.6		320		16,952		17.1	
	East	658	–		–		46.2		231		12,253		13.9	
MKAD	North	362	–	244	–	12,918	–	36.0	–	–	7,304	9,736	7.2	23.1
	Northwest	308	205		10,874		47.2		–		11,903		23.5	
	South	260	–		–		–		–		10,370		48.6	
	West	1,789	283		15,024		24.0		–		9,987		26.7	
	Southwest	215	237		12,585		43.8		–		7,151		20.2	
	East	248	–		–		–		–		6,739		5.7	
Total		**15,714**	**465**		**24,662**		**20.5**		**262**		**13,899**		**17.0**	

Source: Knight Frank Research, 2016

Forecast

We expect the H1 trends to continue in H2 2016 in the office real estate market of Moscow.

Most developers have suspended development of new projects due to uncertain prospects for economic and real estate market recovery. Mainly office buildings scheduled for 2015 or earlier will be delivered in the next two years: 71% of the growth of office space will be formed by deferred delivery. In 2017 we expect a minimum growth volume in the history of the office real estate market of Moscow.

According to our estimates, the 2016 take-up of office space may slightly exceed last year's figure. The stabilization of the Russian ruble and the improving outlook for the development of the Russian economy may influence the company's' sentiment towards lease and purchase of office space. According to our expectations, the revision of lease agreements will be the issue of tenants' activity in a lesser extent. The companies will choose moving to new offices or extending their lease terms on more favorable terms in the context of low rental rates.

Competition among landlords is still high, and therefore the rental rates will not demonstrate a significant dynamics, but the rents in some business districts may go down in connection with the delivery of new office buildings.

RESEARCH
Olga Yasko
Director, Russia & CIS
olga.yasko@ru.knightfrank.com

OFFICES
Konstantin Losiukov
Director
konstantin.losiukov@ru.knightfrank.com

+7 (495) 981 0000

Knight Frank

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