

RESEARCH



20 IN RUSSIA
YEARS

Q3 2016 OFFICE MARKET REPORT Moscow

HIGHLIGHTS

Class A and B new delivery volume of Q1–Q3 2016 has been down last year by 45%.

Class A vacancy rate has reached 22.5% and Class B – 16.5% in Q3 2016

Rental rates denominated in Russian rubles have shrunk 2.8% in Class A offices and 11.4% in Class B since the beginning of 2016.

OFFICE MARKET REPORT MOSCOW



Konstantin Losiukov
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"Office real estate market has entered stagnation phase in 2016 after it's dynamic fall. Tenants are still trying to optimize their rental costs mainly by relocation or extension of their current lease agreements on more attractive terms.

Landlords of most efficiently occupied properties have put up rents for the remaining units despite the lack of assumptions for growth of rental rates. Thus, a certain growth of commercial terms can be expected in some districts affected by vacant space decline".

Key indicators. Dynamics*

		Class A	Class B
Total stock, thousand sq m		15,795	
including, thousand sq m		3,859	11,936
New delivery volume in Q1–Q3 2016, thousand sq m		257	
including, thousand sq m		39	218
Net take-up, thousand sq m		382	
including, thousand sq m		227	155
Vacancy rate, %		22.9 (-0.5 p. p.)*	16.5 –
Average weighed asking rental rate**	USD/sq m/year	455 (-4.0%)*	252 (-11.6%)*
	RUR/sq m/year	24,434 (-2.8%)*	13,384 (-11.4%)*
Rental rates range**	USD/sq m/year	280–850	250–650
	RUR/sq m/year	10,000–45,000	6,000–35,000
OPEX rate range***, RUR/sq m/year		4,000–7,000	2,500–4,500

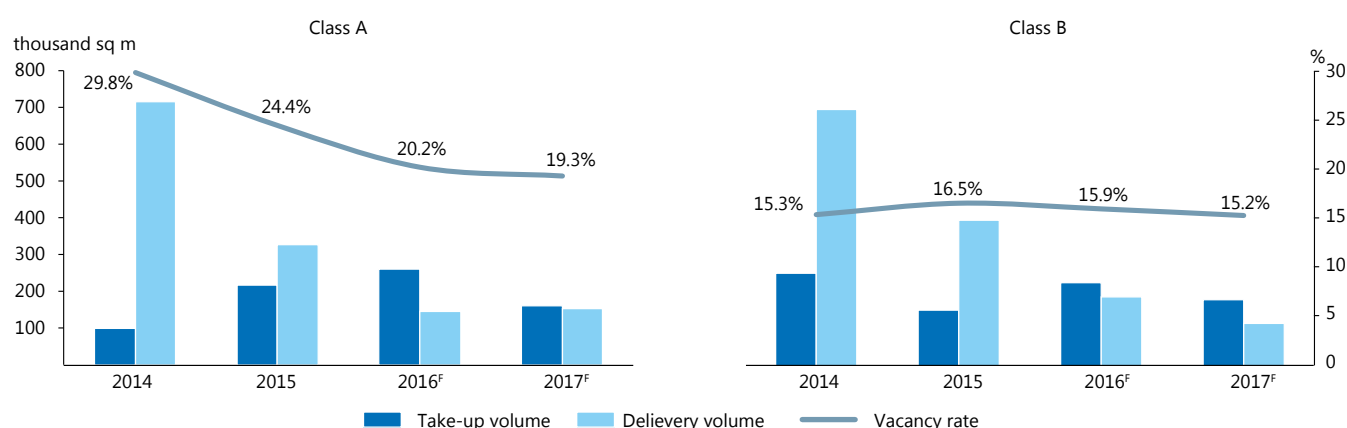
* Compared to Q4 2015

** Excluding operational expenses utility bills and VAT (18%)

*** OPEX rate does not consider change related to property tax rate increase

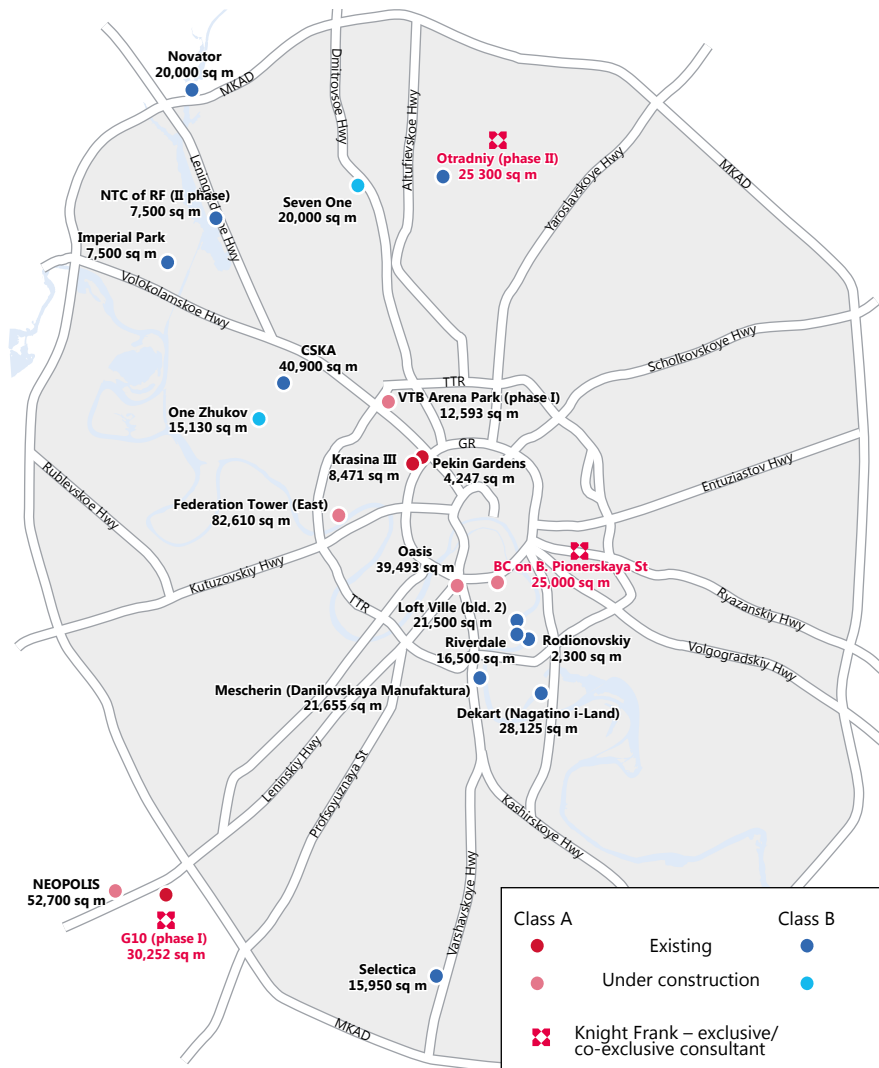
Source: Knight Frank Research, 2016

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



Source: Knight Frank Research, 2016

Key office projects delivered in Q1–Q3 2016* and due to be commissioned in 2016

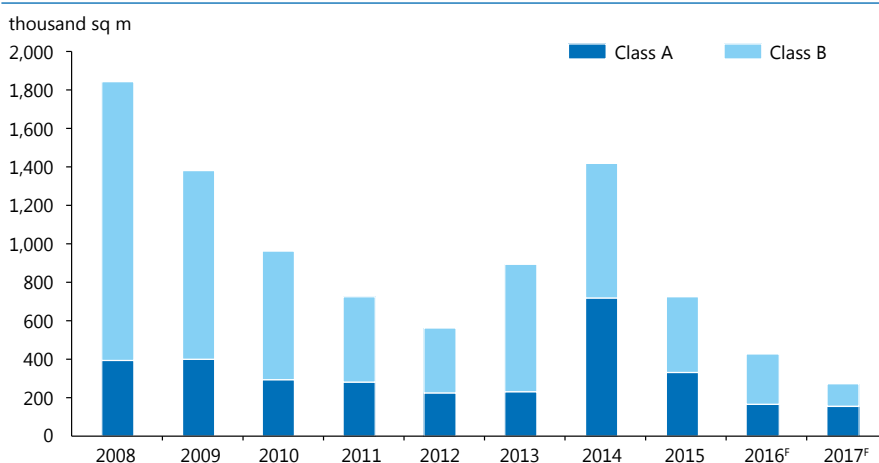


* Office properties that received the delivery act in Q1–Q3 2016

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

Source: Knight Frank Research, 2016

Class A and B new delivery volume dynamics



Source: Knight Frank Research, 2016

Supply

Moscow office total stock has reached 15.8 million sq m in Q3 2016. The delivery volume of Class A and B offices for Q1–Q3 was down on last two years by 45% and 75%, respectively. In absolute terms it amounts to 257 thousand sq m, with 15% corresponding to Class A offices.

New office space growth will hit new lows of the Moscow office market history till the end of this year. Projects planned for commissioning in Q4 have already been finished but the developers are delaying delivery process till the minimum required rental payments will be secured.

Class A vacancy rate have been strengthened by 2.4 p. p. in Q3 2016 to 22.9% owing to the launch of 55 thousand sq m of office sublet space. Class B index demonstrated a downward trend by 1 p. p. less reaching 16.5%.

The shortage of office units of over 10 thousand sq m is typical for some central business districts today. This is since vacancy is originated from the delivery of properties with construction permit obtained before 2011 as a result of limited construction in the centre. Moreover, office units become available for lease in the business centres where companies optimize occupied space. Meanwhile, today MIBC Moscow City and Paveletskiy business district accommodate circa 40% of Class A office space available for lease (including buildings under construction), which equals 430 thousand sq m.

Demand

Net take-up of quality office space has reached a total of 382 thousand sq m in Q1–Q3 2016. The take-up volume equaled to 188 thousand sq m net of transactions on transfer of ownership rights for Eurasia Tower to VTB Group and President Plaza to Sberbank offset against indebtedness. Negative net take-up in Class A office market was registered in Q3 2016 (due to the increase in sublet office supply).

Since 2014 the demand for office space has been largely caused by the desire of companies to reduce rental costs. However, today companies are exploring opportunities relocate, while a year ago tenants preferred to renegotiate lease terms. Thus, the volume of lease renegotiation transactions was down by half on last year and the volume of new lease transactions went up by 16%. The renegotiation transactions have no longer occupy the largest share in the total volume of transactions for the first time since the beginning of 2015.

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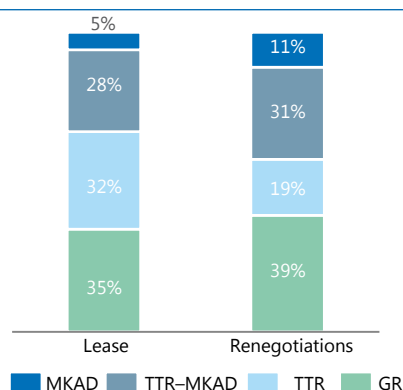
Companies operating in the sphere of high technology, media and telecommunications were the most dynamic to lease office space in the first three quarters of 2016 with 21% in the total volume of transactions from January to September. Wherein, about 70% of office space leased by TMT companies are located within the Third Transport Ring. Interestingly,

the demand from this sector was focused mainly on the decentralized properties two years ago: 50% of transactions were closed in business centres located close to Moscow Ring Road.

Decentralization of business life started in 2012–2014 today is virtually invisible. Several years ago companies chose remote business

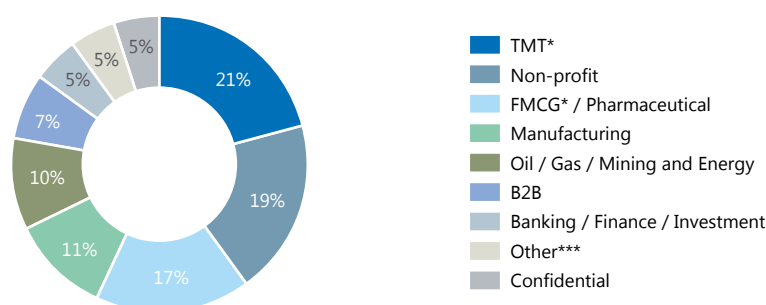
centres to lease significant office space at a low rental rate. Today, these options are available in properties located close to the city centre benefiting from good transport accessibility. The share of lease transactions in properties located near Moscow Ring Road reached 33% last year, compared to 5% in Q1–Q3 2016.

Distribution of transactions by type and location



Source: Knight Frank Research, 2016

Tenant mix



* Technology, media and telecommunications

** Fast moving consumer goods

*** Real estate/ Transport and Logistic

Source: Knight Frank Research, 2016

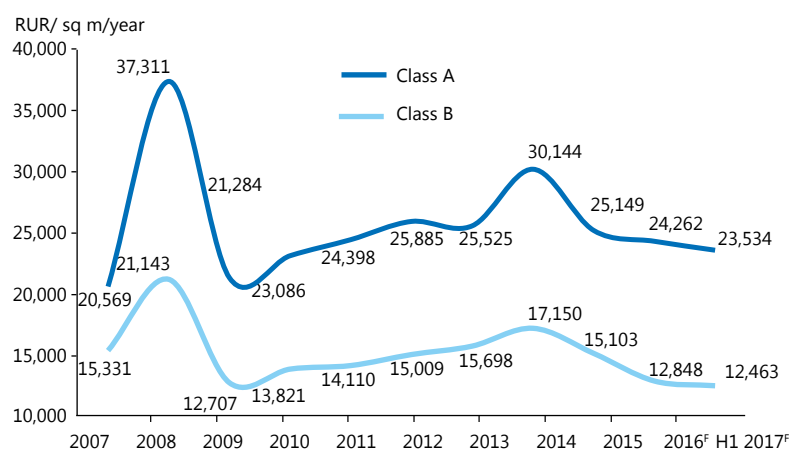
Key lease and purchase transactions closed in Q1–Q3 2016

Company	Area, sq m	Office building	Class	Address
VTB	86,834	Eurasia Tower	A	12 Krasnopresnenskaya Emb
Moscow City Government	55,123	Oko	A	21 Krasnogvordeyskiy 1-st Passage
RUSAL	15,351	Park Pobedy	B+	1 Vasilisi Kozhinoy St
Samsung	10,000	Novinskiy Passage	A	31 Novinskiy Blvd
CDIIS (Transneft)	9,000	Ina House	B+	2 Pavlovskiy 3-rd Lane
Alma Group	7,300	Mercury City	A	15 Krasnogvordeyskiy 1-st Passage
Pro Gres	7,300	Gazoil Plaza	B+	43 Khersonskaya St
Servier	5,985	White Gardens	A	7 Lesnaya St
Ipsos*	5,100	Krasnoselskiy	B+	3 bld 2 Verhnaya Krasnoselskaya St
Binbank	5,100	Dominion Tower	A	5 bld 1 Sharikopodshipnikovskaya St
Philip Morris*	4,784	Kuntsevo Plaza	A	19 Yartsevskaya St
FIFA World CUP Committee Russia-2018	4,416	Dom Park Kultury	A	11A Zubovskiy Blvd
36.6 Pharmacy	4,400	Park Pobedy	B+	1 Vasilisi Kozhinoy St
ITSC	4,155	9 Akrov (phase II)	B+	19 bld 2 Nauchniy Passage
TNS Energo	4,142	Nastasyinskiy	B+	4 bld 1 Nastasyinskiy Lane
REA Kapitalnoye Stroitelstvo*	3,720	Port Plaza	B+	6 Proektiruemyy Passage #4062
Game Insight*	3,311	Gorky Park Tower	B+	15A Leninskiy Ave
Ivanyan & Partners	3,300	17 Plotnikov Lane	B+	17 Plotnikov Lane
Parallels Desktop Research	3,135	Bolshevik	A	15 Leningradskiy Ave
Odin	3,135	Bolshevik	A	15 Leningradskiy Ave
Armo Group	3,118	Arcus II	B+	37A bld 14 Leningradskiy Ave
AKIG	3,092	Empire business high-rise	A	6 bld 2 Presnenskaya Emb
Rusatom Overseas	3,010	Simonov Plaza	B+	26 bld 5 Leninskaya Sloboda St
PIK-Comfort*	2,825	Sirius Park	B+	3 bld 2 Kashirskoe Hwy

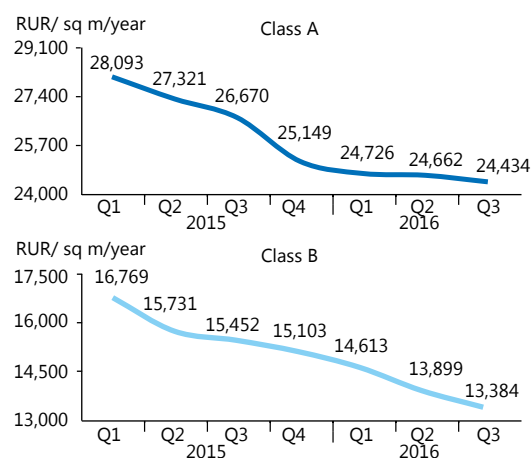
* Knight Frank acted as a consultant of the transaction

Source: Knight Frank Research, 2016

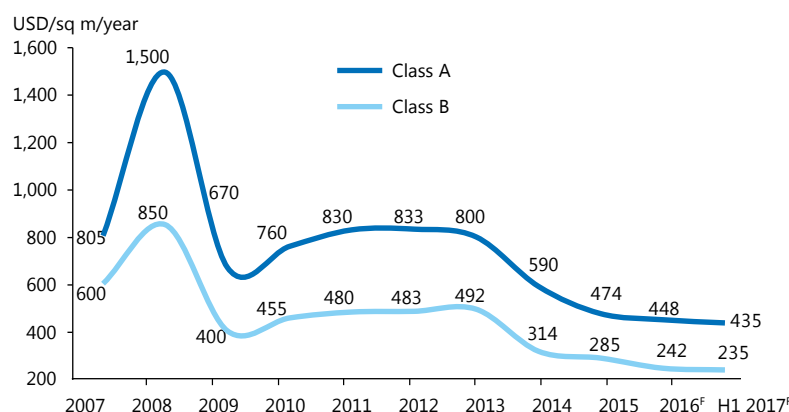
Average asking rental rates dynamics for Class A and B offices denominated in RUB



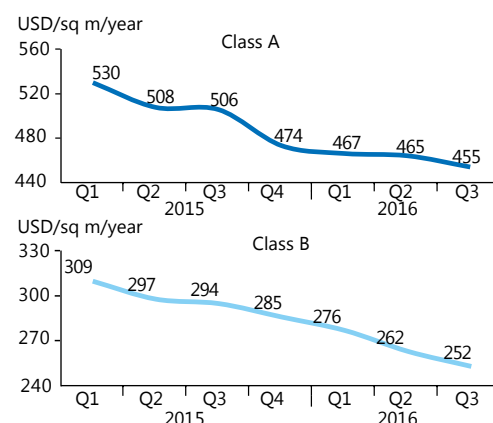
Source: Knight Frank Research, 2016



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



Source: Knight Frank Research, 2016



Commercial terms

Dynamic Class A rental rate decline started in 2014 lost its steam in 2015 to go into stagnation phase remaining in force already for the past three quarters of 2016: only 1.2% drop of the average ruble rental rate from the beginning of this year. Class A offices average rental rate is 24,434 RUR/sq m/year and 455 USD/sq m/year at the end of Q3 2016.

The most significant rental decrease for last 3 years in Class A offices was registered in business centres located close to Moscow Ring Road as well as in the offices of MIBC Moscow City: average rental rates dropped almost two-fold in USD terms due to the high competition caused in turn by office premises oversupply in these business districts.

The smallest decline in rental rates has been recorded in the offices of Central business district in the past three years: average

reduction has only been 13% in dollar terms due to the high occupancy rate of offices in this location.

Class B rental rates continue to slide: landlords of Class B offices have to reconsider the rents downwards in the extremely competitive market on the part of more quality offices with available space offered for lease on attractive terms. Thus, Class B rents have shrunk by 8.4% to 13,384 RUR/sq m/year from the beginning of the year.

Forecast

According to our estimates, circa 420 thousand sq m of quality office space will be delivered in 2016 and 270 thousand sq m in 2017. Thus, the delivery volume in 2017 will update the historical low of this year and by 90% will be formed by properties with commissioning dates postponed from 2015 and 2016.

Net take-up growth of quality office space against the expected decline of new delivery volume will lead to further vacancy rate reduction in offices of Moscow. We assume that vacancy rate could reach 20.2% in Class A offices and 15.9% in Class B by the end of the year; decrease of this index is expected to be 1–1.5 p. p. in 2017.

Asking rental rates increase will occur unevenly as long as the market will be recovering. This growth is primarily expected in business districts that are mostly in demand against falling rental rates – between the Garden Ring and the Third Transport Ring. Landlords of office buildings near Moscow Ring Road will increase the rates at the end of the line on a background of high competition with both decentralized and less remote properties. Rental growth may not happen before the second half of 2017.

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Moscow submarket data. Key indicators

Submarket		Lease area, thousand sq m	Class A					Class B				
			Average rental rates			Vacancy rate, %		Average rental rates			Vacancy rate, %	
			USD/sq m/year		RUR/sq m/year			USD/sq m/year		RUR/sq m/year		
Boulevard Ring	Central business district	712	858		46,348	18.0		452		23,961	9.2	
Garden Ring	South	918	481	493	25,863	19.9	19.5	561	454	29,756	18.3	11.9
	West	286	–		34,934	19.4		–		22,162	14.2	
	North	660	–		24,578	18.7		462		24,465	7.9	
	East	401	–		24,482	22.5		322		17,142	13.4	
Third Transport Ring	Khamovniki	260	708	550	37,519	15.5	22.0	–	265	26,650	5.8	16.0
	Leninskiy	278	–		–	–		–		14,346	18.3	
	Tulskiy	985	–		–	–		–		12,049	12.9	
	Kievskiy	424	–		25,544	14.4		–		13,263	54.0	
	Presnenskiy	357	–		24,958	4.8		–		17,551	14.9	
	Prospekt Mira	162	–		–	–		–		19,114	53.0	
	Tverskoy-Novoslobodskiy	752	573		32,107	29.4		340		18,032	11.5	
	Basmaniyn	532	–		–	–		–		14,632	14.1	
	Taganskiy	234	–		–	–		293		15,551	9.4	
	Volgogradskiy	434	–		–	–		–		14,445	15.7	
MIBC Moscow-City		913	542		28,717	20.9		–		–	–	
TTR-MKAD	North	627	–	350	25,000	11.6	23.4	–	241	12,042	16.6	16.3
	Northwest	692	446		23,646	12.3		–		14,058	15.1	
	South	1,152	–		–	–		–		10,834	19.4	
	West	550	–		–	–		313		16,602	23.5	
	Southwest	626	–		17,828	40.4		246		13,023	16.7	
	East	658	–		11,591	57.0		168		8,900	10.1	
MKAD	North	362	–	258	–	–	35.1	–	–	7,225	7.0	22.2
	Northwest	308	–		10,874	45.2		–		11,641	25.2	
	South	260	–		–	–		–		9,395	45.7	
	West	1,789	323		17,119	24.7		–		9,523	25.5	
	Southwest	215	–		13,407	42.8		–		7,089	15.7	
	East	248	–		–	–		–		3,794	3.7	
Total		15,795	455		24,434	22.9		252		13,384	16.5	

Source: Knight Frank Research, 2016



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