RESEARCH

Q1 2013
OFFICE MARKET REPORT
Moscow
Knight Frank

HIGHLIGHTS

- The new stock volume of Class A and Class B office space amounted to nearly 260 thousand sq m, almost doubly exceeding the figure for the same period of last year.
- According to the results of Q1 2013, about 150 thousand sq m of office space was leased and purchased. This value is at the level of last year.
- The vacancy rate has changed in comparison with Q4 2012 and amounts to 14.5% for Class A office buildings and 12.8% for Class B.
- Rental rates are the same as at the end of last year: in the range of 700–1,200 $/sq m/year for Class A office centers and 350–650 $/sq m/year for Class B.
- In the next three years, we anticipate stable demand from tenants and buyers, as well as further recovery in new construction volumes of Class A and B office space.

OFFICE MARKET REPORT

Nikola Obajdin,
Director, Office Department
Knight Frank

«As per our expectations, the new construction volumes have been restored during the first months of the year. Furthermore, the properties whose construction was previously postponed, have also reemerged on the market. Besides, new high-quality office centers were announced: they are in demand by both Russian and foreign companies. Developers are paying increased attention not only to the quality of the object itself, but also to the improvements of adjacent territories' infrastructure, which is common for business districts of developed markets of the world capitals. A number of developers announced plans for certification of their properties under the international energy efficiency rating systems standards, and in the coming years, we expect a significant growth in the number of "green offices", which also indicates transition to the phase of qualitative market development».

Supply

The total stock of high-quality office space in Moscow in Q1 2013 exceeded 12.7 million sq m and amounted to 2.63 million sq m in Class A and 10.1 million sq m in Class B.

In the first three months of 2013, the delivery of high-quality office space amounted to almost 260 thousand sq m, which is more than twice as much as for the previous year, and is also the highest quarterly value since Q4 2010. This significant growth resulted from the increased activity of developers, resuming implementation of pending projects postponed during the recession, as well as the delayed delivery of the properties planned for market introduction by the end of last year.

Key indicators. Dynamics*

Indicators	Class A	Class B
Total stock, thousand sq m	12,728	
including, sq m	2,634	10,094
	+2.0%	+1.8%
Delivered in Q1 2013, thousand sq m	259	
including, thousand sq m	75.8	183.7
Vacancy rate, %	14.5	12.8
	(+1.9 p.p.*)	(-1.7 p.p.*)
Average weighted asking rental rate**, $/sq m/year	834	483
	▶	▶
Rental rates range**, $/sq m/year	650–1,200 (1,000–1,300***)	350–650
Operational expenses, $/sq m/year	110–210	50–120

* Comparing to the end of 2012
** Excluding Operational Expenses and VAT (18%)
*** Range of asking rents for premium space
Source: Knight Frank Research, 2013

In Q1 2013, two Class A objects were delivered: the office complex White Gardens and a business center Rosso Riva. Until the end of the year, we expect the construction of another eight Class A office centers to be completed, including a business center Wall Street on the Garden Ring, the Mercury Tower in MIBC Moscow-City, as well as the second stage of the business center Morozov in the Red Rose business district. According to our forecast, high volumes of new space delivery will continue throughout the year and will exceed the 2012 figure by almost 30%.

The share of sites located within the Garden Ring is dropping significantly in the structure of new stock. The formation of decentralized areas of business activity, which started about 5 years ago, will continue in 2013. Since the beginning of the year, only about 7% of new office space in Class A and B is situated in the properties located inside of the Garden Ring, and by the end of the year, according to our forecast, the share of such facilities will not to exceed 10%.

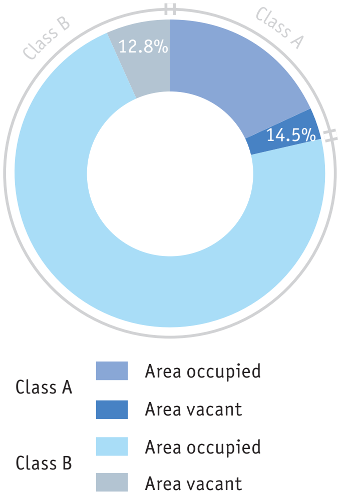
Key projects delivered* in the Q1 2013

Office building	Address	Office area, sq m
Class A		
White Gardens	27 Lesnaya St	63,900
Rosso Riva	4/2 Shlyuzovaya Emb	11,947
Class B+		
Navigator (phase II)	47 bld. 5 Varshavskoe Hwy	52,000
Lotte	65 Profsoyuznaya St	28,500
Levium Centre	58 Nakhimovskiy Ave	15,256
City Point	11 Krasnopresnenskaya Emb	9,951

*Office projects, that passed State Commission in Q1 2013. Classes according to Moscow Research Forum
Source: Knight Frank Research, 2012

Rosso Riva Business Centre
4/2 Shlyuzovaya Emb

In Q1 2013, the vacancy rate in Class B was lower than in Class A



Source: Knight Frank Research, 2013

Demand

For the three months, we have observed steady demand from the tenants. The transactions volume on lease and sale of office space in Class A and B reached approximately 150 thousand sq m, which is comparable to last year. Traditionally, the beginning of the year is a period of low business activity, however a number of transactions is currently under negotiation, and we expect an increase of this figure already in the coming quarter.

The vacancy rate has changed compared to Q4 2012 and amounted to 14.5% (an increase of 1.9 p.p.) for Class A office buildings and 12.8% for Class B (a decrease of 1.7 p.p.). This dynamics is determined by the desire of some companies to move from lower-quality offices into Class B business centers, leading to an increase in the take-up volume of Class B office space. Objects of this class attract the tenants with more flexible lease terms, an option to lease office blocks with a finish, as well as with a broader choice of stock, compared to Class A. Besides, considering a somewhat unstable economic situation, some private investors wish to diversify their assets portfolio, by purchasing smaller office spaces for the purpose of then leasing them out. They generate demand specifically for units in Class B category, as the purchase of small-space offices in business centers of Class A is practically impossible.

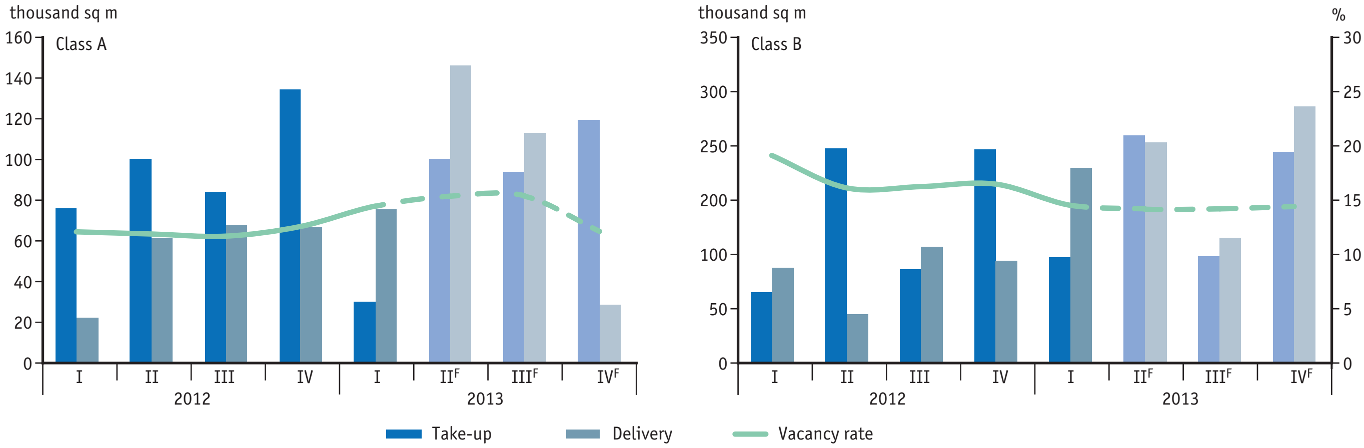
The greatest demand in Q1 2013 was observed on the part of IT and telecommunications companies, whose share reached almost 30% of the total take-up of high-quality office space. The share of space occupied by companies of mining sector (oil and gas corporations) has also grown, primarily due to a large office space lease deal by the OJSC Gazprom. Traditionally, there was a steady demand from the companies in financial sector, as well as B2B, which collectively leased and purchased nearly a quarter of all Class A and B office space. By the end of the first three months, the demand from

Key lease deals in Q1 2013

Company	Lease Area, sq m	Address	Office Building
Gazprom	24,606	118 bld. 1 Varshavskoe Hwy	Varshavka-Sky
Tinkoff Credit Systems	7,287	38A Khutorsjaja 2-nd St	Mirland
INLINE Technologies	5,000	39 Leningradskoe Ave	Skylight
Roszheldorproekt	3,467	42 bld. 2A Schepkina St	Chaika Plaza IV
Gazpromneft-Center	2,619	10/5 Letnikovskaya St	
Nikon	2,014	1 Syromyatnicheskiy 2-nd Lane	Delta Plaza

Source: Knight Frank Research, 2013

Delivery volume of quality office premises has recorded the historical minimum since 2004



Source: Knight Frank Research, 2013

manufacturing companies and FMCG companies dropped by half, accounting overall for almost 15% of the total take-up.

Commercial terms

The weighted average rental rates for Class A and B office space, having remained stable for over a year, continue this trend. A rare exception to this has happened at the end of 2012 were some of the properties have demonstrated a minor correction towards an increase, which resulted from shortage of space in a particular building and/or district. By the end of the three months, asking rental rates remained at 834 $/sq m/year for Class A and 483 $/sq m/year for Class B.

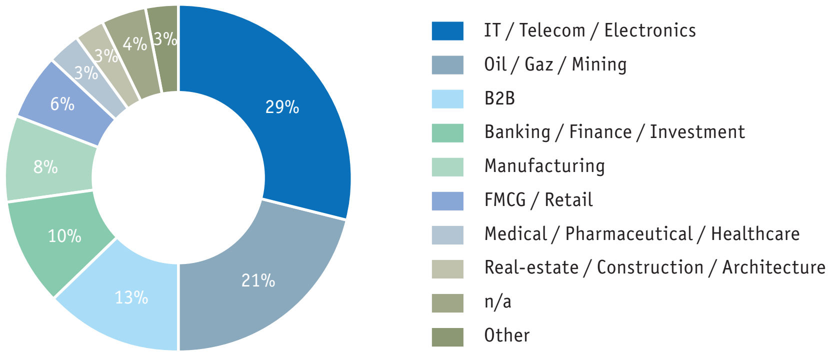
Forecast

In our opinion, the recovery in new construction volumes, which began in 2013, will continue in 2014–2015 as well. We expect that the amount of delivered office space in the next three years will amount to just above 3 million sq m. Furthermore, over 90% of office space will be delivered outside the Garden Ring. By 2015, the construction of most of the MIBC Moscow-City projects will have finished, – thus the office stock volume in the area will exceed one million sq m.

According to the World Bank report on Russia's economy #29, the country is expected to experience moderate economic growth of 3.6–3.8% per year. The Ministry of Economic Development had similar expectations at the beginning of the year as well. Against the backdrop of moderate economic growth, we expect stable demand for high-quality office properties in the next three years.

With regard to internal factors determining the structure of demand, it is worth noting that in 2011–2012, it was formed for the most part through return to the market of those tenants

In Q1 2013, the IT and telecommunication, as well as oil and gas companies have leased nearly half of office space in Class A and B categories

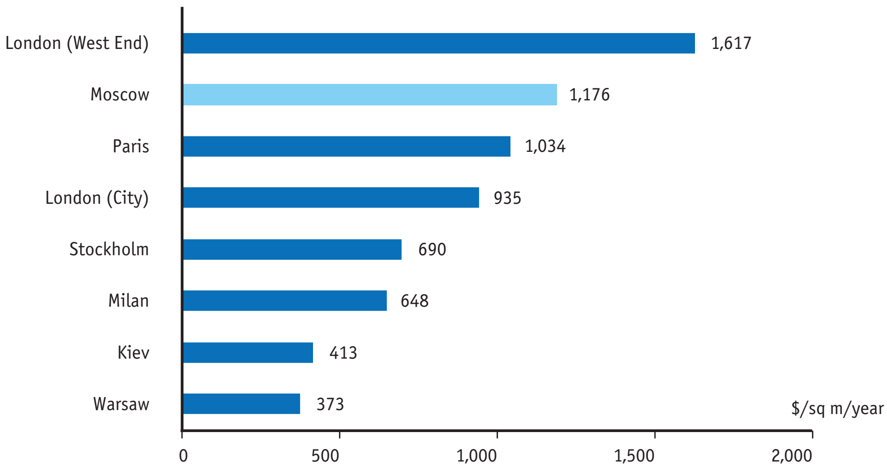


Source: Knight Frank Research, 2013

Dudkino Business Park
0.5 km from MKAD, Kievskoe Hwy

Mebe One Khimki Plaza Business Centre
25 Leningradskaya St, Khimki

In comparison with the markets of European cities, Moscow still occupies one of the top positions, concerning rental rates on premium offices, it is second only to London (West End district)



Source: Knight Frank Research, 2013

who have signed contracts in 2007–2008. Back then, five years ago, the vacancy rate was below 5% and in some areas there was no vacancy at all leading to a very limited choice. Furthermore, the properties leased in 2007–2008, were started to be built in 2004–2005, when currently existing classes have only just been defined. In recent years, the market has undergone qualitative development, and large corporate tenants often demonstrate willingness to move into new buildings, often of superior quality. We expect that the basis of demand for Class A and B+ offices in 2013–2015 will be formed by the lower class tenants, as well as companies that are expanding, yet may not realize this need within their current properties.

In view of market factors: the new construction volume ratio and take-up levels, – one can expect with high probability that the average annual rental rate for Class A and B properties in 2013 will remain at the level of 2012. Any special cases correcting this indicator will depend only on the specificity of the situation in the object.

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