

A low-angle, upward-looking photograph of several modern skyscrapers with glass facades, reflecting the sky and each other. The perspective creates a sense of height and architectural grandeur.

Q3 2013 OFFICE MARKET REPORT Moscow

HIGHLIGHTS

- In total, from January to September, 586 thousand sq m of Class A and B office space have been delivered, which is 33% more than for the same period last year and is the highest indicator since 2010.
- About 500 thousand sq m of high-quality office space were leased and purchased from January to September of 2013.
- The vacancy rate in Class A business centers grew by 6 p. p. compared to Q4 2013 to 18.6%. In turn, the vacancy rate in offices of Class B from January to September 2013 dropped by 3.9 p. p. reaching 10.6%.
- In the past months of 2013, the average asking lease rate for Class A offices dropped by 3.9% to 800 \$/sq m/year. The average weighted asking lease rate for Class B office premises has not changed in comparison with Q4 2012 and is 483 \$/sq m/year.

OFFICE MARKET REPORT



Konstantin Losyukov,
Director,
Office Department,
Knight Frank

"The office real estate market of Moscow is still quite young and unsaturated in comparison with the markets of major cities in the Western Europe. The first spike of serious growth could be observed in 2007. Economic recession that followed in 2008–2009, resulted not only in a decline of take-up and lease rates, but also led to a gradual formation of a substantial amount of pent-up demand. In 2010–2011, the pent-up demand has been activated and one could once again observe a growth of market indicators: Class A offices lease rate for the period grew by almost 30% reaching the figure of 830 \$/sq m/year. However, they have not reached the pre-recession levels, even though against the background of the post-recession decline in new construction volumes, a situation of high-quality facilities shortage was observed.

Subsequently to those rash fluctuations, the market is presently moving towards a stable state and a small downward correction of rates suggests that a slight "overheating" has been in effect.

The office real estate market of Moscow continues its qualitative development with new interesting projects, a growing volume of "green offices" supply and the reinforcement of decentralization trend".

Supply

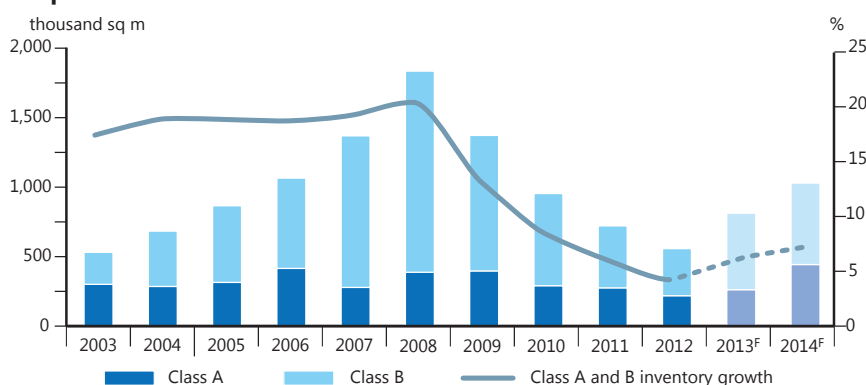
The total supply stock volume of high-quality office space exceeded 13 mln sq m, reaching the figure of 2.7 mln sq m for Class A offices and 10.4 mln sq m for those of Class B by the end of Q3 2013.

Following the record-low office space delivery volume of 2012, the market of today is characterized by the expected growth of new high-quality office space supply. In total, from

Key indicators. Dynamics

Indicators	Class A	Class B
Total stock, thousand sq m	13,033	
including, thousand sq m	2,683	10,350
Delivered in Q1–Q3 2013, thousand sq m	586	
including, thousand sq m	225	361
Vacancy rate, %	18.6	10.6
	+6 p. p.*	-3.9 p. p.*
Average weighted asking rental rate**, \$/sq m/year	800	483
	-3.9%*	-
Rental rates range**, \$/sq m/year	400–1,200 (1,000–1,300***)	350–1,000
Operational expenses, \$/sq m/year	110–210	80–120
* Comparing to Q4 2012		
** Excluding Operational Expenses and VAT (18%)		
*** Range of asking rents for premium space		
Source: Knight Frank Research, 2013		

In 2013, the highest delivery volume of Class A facilities for the past 4 years is expected



Source: Knight Frank Research, 2013

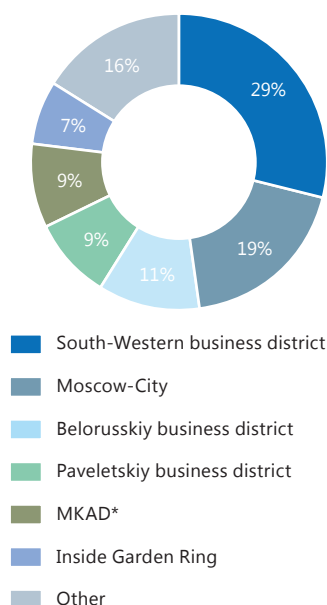
January to September, 586 thousand sq m of Class A and B office space have been delivered, which is 33% more than for the same period last year and is the highest indicator since 2010.

Almost 85% of high-quality office space delivered within the past 9 months is located outside the Garden Ring, which indicates the continuing decentralization of the Moscow office market. Nonetheless, a construction of

several office properties with a total area of 150 thousand sq m inside the Garden Ring is planned for completion by the end of 2014.

It should be noted that for Q1–Q3 2013, the supply stock volume of office space certified according to the international environmental standards has grown by more than 100 thousand sq m, and a delivery of another 75 thousand sq m of energy-efficient offices is expected the coming year.

Delivery of office premises in the decentralized business districts of Moscow, Q1–Q3 2013



Source: Knight Frank Research, 2013

* Office centers located on the distance up to 500 m from MKAD

Demand

About 500 thousand sq m of high-quality office space were leased and purchased from January to September of 2013. Low tenant and buyer activity on the office market characterized H1 2013. However, in Q3 2013, there occurred an expected growth in demand resulting from the seasonality of the office market.

The vacancy rate dynamics for Class A and B office centers during the past months of 2013 was mixed. In comparison with Q4 2012, the vacancy level in Class A business centers grew by 6 p. p. to 18.6%. This growth resulted from the delivery of several large-format office buildings against the background of strong demand. As preliminary office space lease agreements are rarely concluded until the building is operational – the total vacancy rate grows when large objects are delivered.

In turn, the vacancy rate in offices of Class B for Q3 2013 showed the lowest value of the past five years: from January to September 2013, the figure gradually dropped by 3.9 p. p. reaching 10.6% by the end of the period under consideration.



Mebe One Khimki Plaza
25, Leningradskaya St, Khimki

Key office projects delivered* in Q1–Q3 2013

Office building	Address	Office area, sq m
Class A		
Mercury City	14 Krasnopresnenskaya Emb	87,574
White Gardens	27 Lesnaya St	63,900
Wall Street	37 Valovaya St	20,493
Country Park III	19 Panfilova St, Khimki	19,120
Leninskiy 119	119 Leninskiy Ave	15,400
Rosso Riva	4/2 Shluzovaya Emb	11,947
Domino	74 Pyatnitskaya St	6,216
Class B		
9 akrov (phase II)	19 Nauchniy passage	62,300
Newton-Plaza	47, bld. 5 Varshavskoe Hwy	52,000
Lotte	65 Profsoyuznaya St	28,500
Quadrum	20B Tsentralnaya St, Mytishi	24,650
iCube	58 Nakhimovskiy Ave	15,256
Sinitsa Plaza (bld. 3,7)	9A, bld. 3, bld. 7 Sinichkina St	13,496
Black & White	14 Kozhevnikovskaya St	13,000
Park Tower	1 Krasnogvardeyskiy 1-st passage	11,850
Smart Park	14, bld. 1A Nauchniy passage	10,260
City Point	11 Krasnopresnenskaya Emb	9,951
Cherry Garden	10/31 Malaya Sukharevskaya Sq	6,736
Central Street	14 Spartakovskaya Sq	6,423

* Office projects that passed the State Commission in Q1–Q3 2013

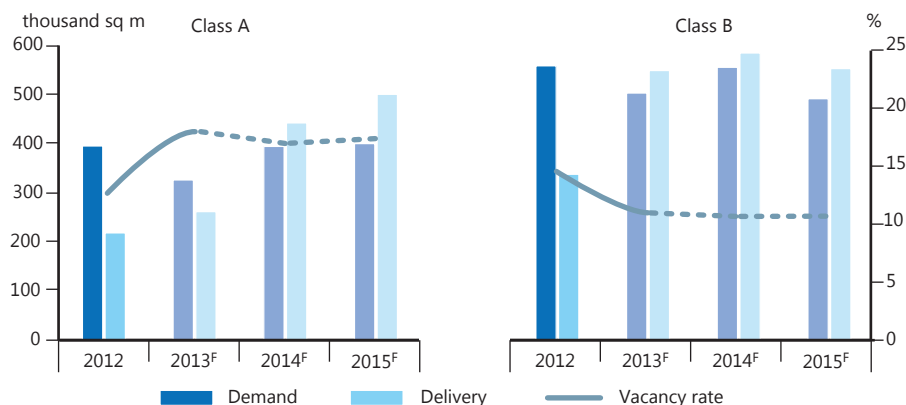
Office building classes according to Moscow Research Forum

Source: Knight Frank Research, 2013

Q3 2013 OFFICE MARKET REPORT

Moscow

The vacancy rate dynamics for Class A and B office centers for the past months of 2013 was mixed



Source: Knight Frank Research, 2013

Speaking of the demand structure, high activity of TMT sector* companies is worth a special notice, as their share has not dropped below 20% for three years already. Between January and September, the companies operating in the field of high tech, media and telecommunications have leased and purchased about 25% of office space in the total volume of demand. The share of companies in financial sector has dropped compared to the same period of the previous year not exceeding 10%, while the share of B2B companies remained unchanged. At the same time, the share of manufacturing companies has been shrinking throughout the

year, while companies operating in the field of production and supply of oil and gas have become more active in comparison with 2012.

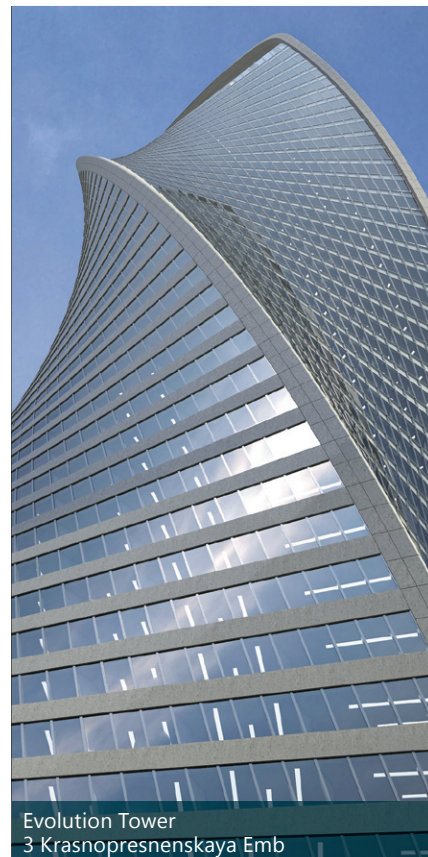
Office property located between the Garden Ring and the Third Ring Road** enjoyed the highest demand: 30% of the total take-up volume for the considered timeframe were leased and purchased here. IT and telecommunications companies as well as organizations that provide B2B services were the most active ones in terms of office space demand in this district. The share of leased and purchased office space in buildings located within the Garden Ring has shrunk: if in 2010–2012 such property accounted for about 30%, during the first 9 months of 2013, only 17% of leased and purchased offices were located in the central part of the city.

For Q1–Q3 2013, almost half of the leased and purchased office space has fallen with properties located outside the Third Ring Road (inside MKAD).

Decentralization on the Moscow real estate market continues for two main reasons. Firstly, the tenants are attracted by the lower lease rates in buildings located outside the city center. The second reason is the decline of new construction volumes in the central part of the city resulting from the directive of Moscow administration. Thus, the tenants of office real estate are offered a greater choice of large office blocks (starting from 5 thousand sq m) outside the city center.

Commercial terms

The range of asking lease rates for high-quality office space in Moscow has grown compared with the end of 2012 and at the end

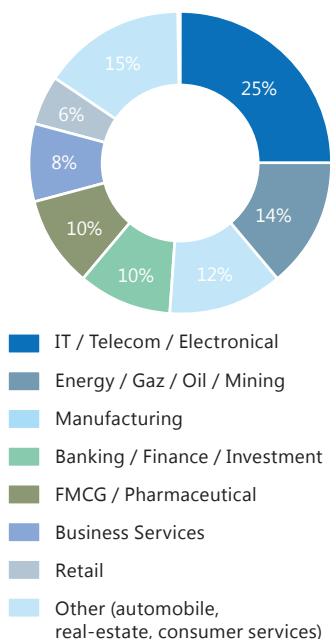


Q3 2013 amounts to 400–1,200 \$/sq m/year for Class A and 350–1,000 \$/sq m/year for Class B.

In the past months of 2013, the average asking lease rate for Class A offices dropped by 3.9% to 800 \$/sq m/year by the end of the period under consideration. The indicator adjustment has occurred largely due to changes in the structure of office supply: namely, the increase in the number of Class A facilities located in remote areas of the city within the total supply stock. It should be noted that lease rates for prime class business-centers of comparable quality located within the Boulevard Ring and adjacent to the MKAD may have an almost triple difference. Besides, the blocks that are offered to lease in the central part of the city are generally smaller and commonly more expensive.

Class B office market is in a balanced state with the demand volume corresponding to the volume of supply. The average weighted asking lease rate has not changed in comparison with the end of 2012 and is 483 \$/sq m/year.

The largest share in the total office take-up volume falls with the TMT companies sector



Source: Knight Frank Research, 2013

* TMT sector includes technology, media and telecommunications companies

** The properties located on the outer side of the Ring Road are taken into account in calculations as adjacent to the corresponding ring

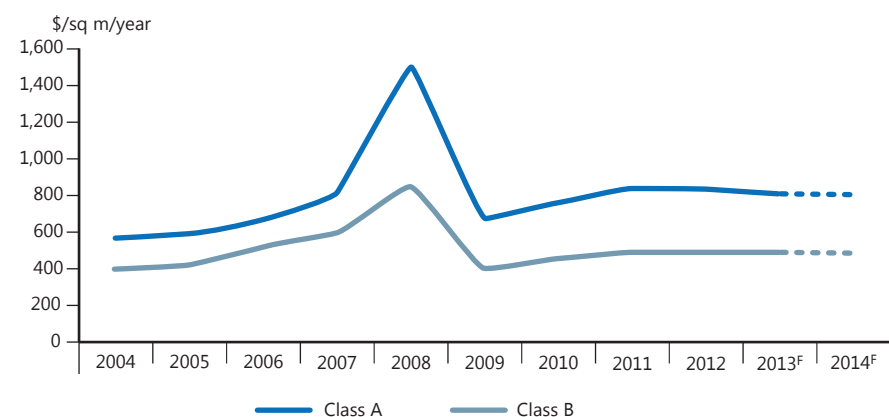


Park Pobedy
1 Vasilisy Kozhinoy St

The average lease rate for Class A offices has slightly dropped due to the change in the structure of supply. Lease rate for Class B offices remains unchanged for the past two years

Starting from 2014, these measures are expected to accelerate the speed of recovery of the Eurozone economy.

The slowdown of the Russian economy is to the greatest extent connected with a drop in external demand and a high level of uncertainty caused by the decline of the Eurozone economy and budget crisis in the United States. Recovery of the European economy will boost confidence of global investment firms towards countries with developing economies. This in turn should reflect on the office real estate market of Moscow, which is a "mirror" of the economic situation: the higher the level of tenants' confidence in their own business, the greater the motivation to expand staff and improve working conditions. In the coming 1–2 years, we expect a recovery in demand for office space in Moscow, as well as the lease rates correction for Class A offices to the level of 2011–2012.



Source: Knight Frank Research, 2013

Forecast

According to our expectations, the volume of new high-quality office space supply will exceed that of the previous year by 30% and amount to about 800 thousand sq m by the end of 2013. A considerable amount of delivered office space will create favorable conditions for the tenants: the vacancy rate will have a tendency to grow, which will facilitate lease rates reduction.

According to the main forecast version of the Ministry of Economic Development, a positive development scenario is expected for the world economy in next few years. It involves overcoming the negative trends of recent years and the acceleration of economic growth. Measures taken to strengthen the integrative mechanisms will contribute to ending the recession and facilitate the return of investor confidence, while stabilizing financial markets in European countries.

In the case that the expectations of primary forecast version of the Ministry of Economic Development will not come to pass – negative trends of current macroeconomic situation will persist. In this case, tenants and buyers of office space will strive to reduce their costs, which will strengthen the demand for Class B office space and will reinforce the trend towards an increase in lease rates for this segment. In this case, one can expect an even greater drop in lease rates for Class A properties.

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