RESEARCH

Knight Frank

H1 2017

OFFICE MARKET REPORT

Moscow

HIGHLIGHTS

- The H1 delivery of Class A and B offices plunged eightfold on a like-to-like basis.
- The fall of average asking rents in both Class A and B offices is still under way, despite the fact that Class B offices saw a slight increase in Q1 2017. The Class A rents were 5.7% down against Q4 2016 reaching 22,904 rub./sq m/year, Class B – 0.7% down – 13,289 rub./sq m/year.
- The Class A vacancy rate of H1 2017 sank by 1.6 p. p. till 19.1% against the end of 2016. The decline of 1.4. p. p. was recorded in Class B offices in H1 amounting to 14.1%.

OFFICE MARKET REPORT MOSCOW

Konstantin Losiukov
Director, Office Department
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"We have witnessed substantial delivery drop of new business centres in H1 2017. Why will you build new ones if the market offers hundreds of thousands of vacant metres? The office real estate market is unlikely undergoing stagnation; it is rather getting through post-crisis stages. Nothing matters more than a moderate but stable demand resulting in vacant space reduction in H1, especially in Class B, most in demand in a down economy. And today the vacancy rate is approaching the level of 8–12%, traditional for the European markets. Class A offices still experience the high vacancy rate circa 20%.

Another 2–3 years can be required to overcome the consequences of the crisis given the current construction speed of business centres and demand volumes. The process of the market recovery will go faster if there will appear new positive factors for economic growth, such as rising oil prices, strengthening of the ruble, and removal of sanctions".

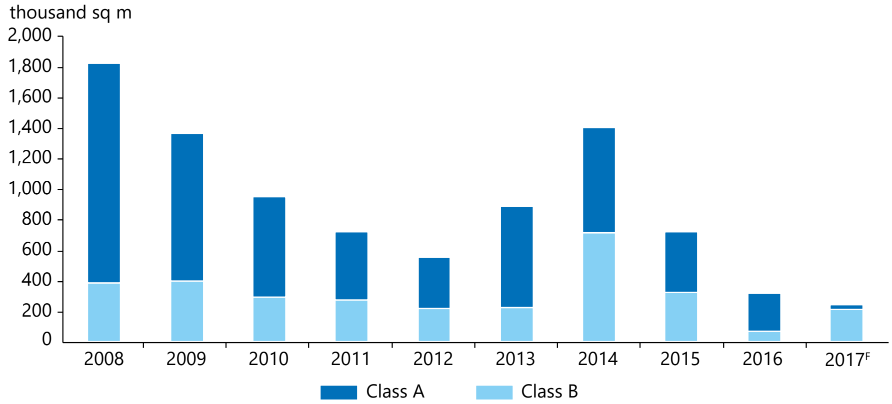
Key indicators. Dynamics*

	Class A	Class B
Total stock, thousand sq m	15,876	
including, thousand sq m	3,905	11,971
New delivery volume in H1 2017, thousand sq m	21	
including, thousand sq m	14	7
Vacancy rate, %	19.1 (-1.6 p. p.)*	14.1 (-1.4 p. p.)*
Average weighed asking rental rate**, rub./sq m/year	22,904 (-5.7%)*	13,289 (-0.7%)*
Rental rates range**, rub./sq m/year	10,000–45,000	7,500–35,000
OPEX rate range***, rub./sq m/year	4,000–7,500	2,500–4,500

* Compared to Q4 2016
** Excluding operational expenses, utility bills and VAT (18%)
*** OPEX rate does not consider change related to property tax rate increase

Source: Knight Frank Research, 2017

Class A and B new delivery volume dynamics



Source: Knight Frank Research, 2017

Map of projects scheduled for delivery in 2017

* Office properties that received the delivery act in H1 2017
The building class is indicated according to the Moscow Research Forum Office Classification of 2013
Source: Knight Frank Research, 2017

Supply

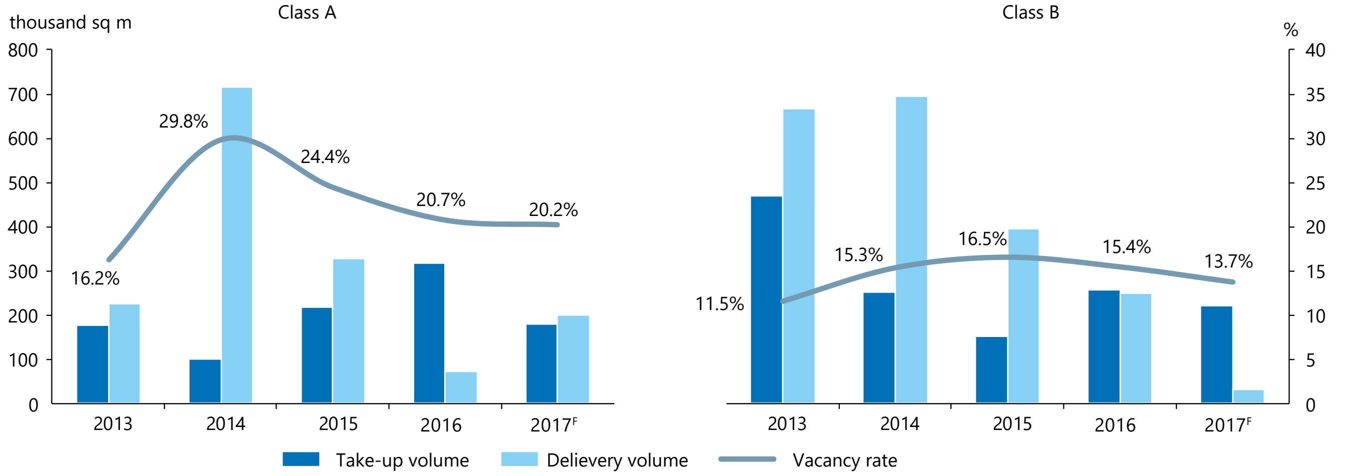
The total office quality stock in Moscow came up to 15.9 million sq m in H1 2017, where 25% or 3.9 million sq m corresponded to Class A offices and 75% or 11.9 million sq m to Class B.

The delivery downward trend of new properties continued in H1 2017. Only 21,000 sq m were commissioned over this period, which was eight times less than last year's figures. Developers postpone the construction start of new facilities and push back the completion dates of projects under construction. They often reduce the office component of projects or completely reject it.

The Class A vacancy rate of H1 2017 ran up to 19.1%, which was equivalent to 760 thousand sq m in absolute values. 1.27 million sq m are vacant in Class B offices, which is 14.1% of the total supply. The vacancy rate is slowly but surely decreasing thanks to the low delivery and small nevertheless stable demand. The Class A vacancy rate sank by 1.6 p. p. against the end of 2016 and Class B index shrank by 1.4. p. p.

A small rise of the Class A vacancy rate is expected over the rest of the year due to the delivery of new office centres. The vacancy rate of Class B offices will continue to move downwards.

The net take-up and vacancy rate dynamics



Source: Knight Frank Research, 2017

Demand

Q2 2017 extended the Q1 trend, when there were fewer transactions with Moscow offices than similar indicators in the past. The Class A and B transaction volume got to 185 thousand sq m in Moscow according to the results of H1 2017, which was more than twofold less than over the same period in 2016. The marketing terms of office facilities have increased, and we are witnessing the return to the market of the practice to conclude exclusive contracts for property marketing. Landlords of the projects not able to find tenants for quite a long time offer such contracts to consultants.

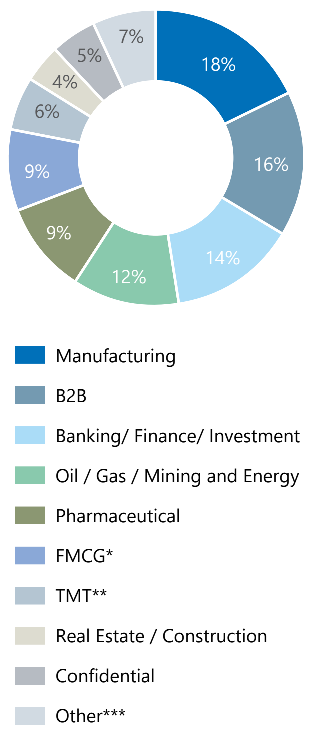
The largest total volume of transactions was concluded by manufacturing companies despite the fact that the largest transactions belonged to companies from the banking and retail sectors. The demand from companies from different sectors is more even in the first half of 2017, and the share of each of them does not exceed 18% unlike in past years, when one of the sectors could account for more than 30% of the total volume of transactions.

The traffic situation in the city centre deteriorating every month and the availability of vacant premises in quality office buildings outside the Garden Ring have driven up the demand for premises located in the area of the Third Transport Ring. The share of new lease transactions in this area was more than 40% in H1 2017. Moreover, more new lease transactions appeared in office centres located between the Third Transport Ring and the Moscow Ring Road. The shift of demand to the territories between the Third Transport Ring and the Moscow Ring Road has also been registered due to the incoming requests from potential tenants, who have been usually looking for offices in the North-West business district of Moscow.

There was a boost of transactions in the first half of the year with office units up to 500 sq m from the same period last year. The share of such small transactions reached 39% in the total amount, going 9 p. p. up compared to the same period in 2016.

During the first half of 2017 it was expected that large holdings, uniting several affiliated companies, would consolidate and optimize their office space. However, after an active analysis of the Moscow office real estate market during the first six months of 2017, most companies planning such consolidation abandoned this idea. Thus, there were no major transactions with office units of more than 20,000–30,000 sq m, which could have a significant impact on the indicators of the total volume of transactions and net take up.

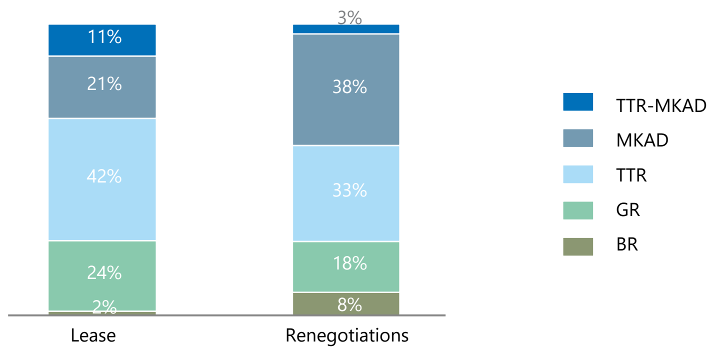
Distribution of leased office space depending on the company profile



* Fast moving consumer goods
** Technology, media and telecommunications
*** Non-profit / Transport&Logistic

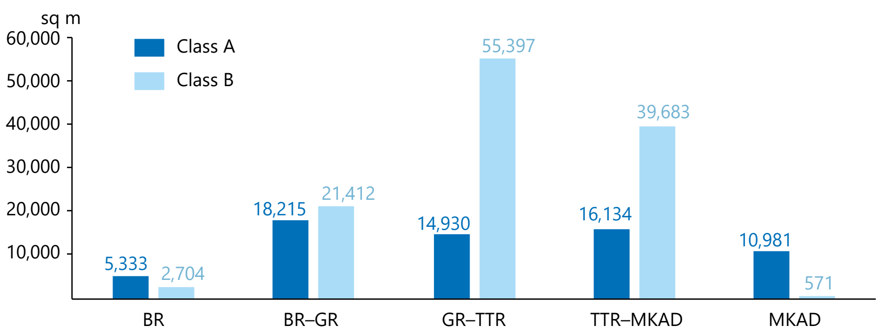
Source: Knight Frank Research, 2017

Distribution of transactions by type and location



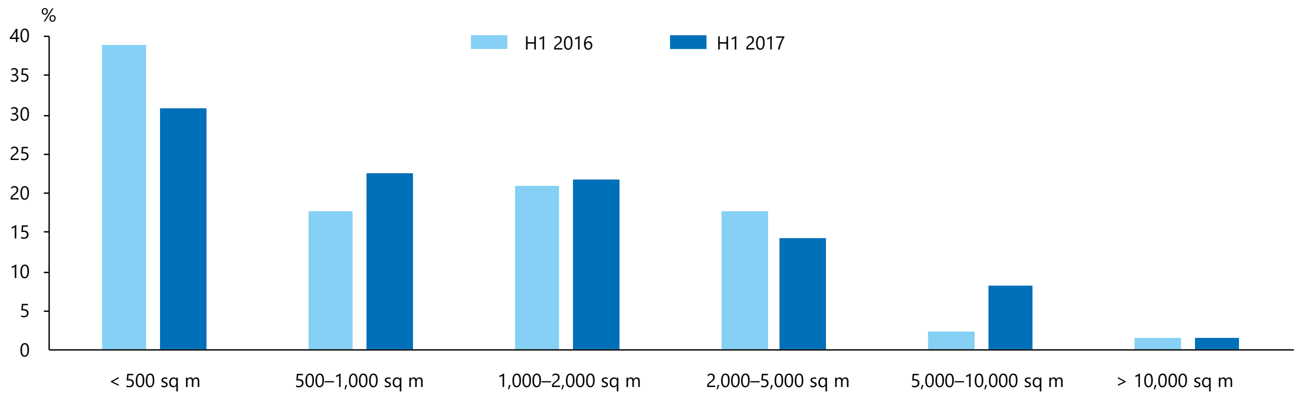
Source: Knight Frank Research, 2017

Distribution of leased office space depending on the location of the office building



Source: Knight Frank Research, 2017

Distribution of leased office units by size



Source: Knight Frank Research, 2017

Key lease and purchase transactions closed in H1 2017

Company	Area, sq m	Office building	Class	Address	Transaction type
BBDO	11,030	Novospasskiy Dvor	B+	Derbenevskaya Emb, 7	Lease
Russian Agricultural Bank	9,200	Incom City	B+	1st Krasnogvardeyskiy Passage, 7, bld 1	Sale
RN-Shelf-Arktika and RN-Exploration	5,500	Atlantik	A	Mozhayskiy Val St, 8	Lease
LOCKO-Bank	4,467	Skylight	A	Leningradskiy Ave, 39	Sale
Samsung R&D Institute Rus	4,375	Dvintsev	A	Dvintsev St, 12, bld 1	Lease
Panasonic*	**3,122**	**Shabolovka 31**	**B+**	**Shabolovka St, 31**	**Lease**
Toyota Bank	3,030	Silver City	A	Serebryanicheskaya Emb, 29	Lease
Solpro	3,018	White Stone	A	4st Lesnoy Lane, 4	Lease
DPD	2,821	LeFORT	B+	Elektrozavodskaya St, 27	Lease
Regus	2,594	Vozdvizhenka Centre	A	Vozdvizhenka St, 10	Lease
GlaxoSmithKline	2,576	Krylatsky Hills	A	Krulatskaya St, 17	Lease
Ingrad Realty	2,523	Hermitage Plaza	A	Krasnoproletarskaya St, 2, bld 13/4	Lease
Workki	2,500	Neo Geo	B+	Butlerova St, 17	Lease
Hays	2,500	Paveletskaya Plaza	A	Paveletskaya Sq, 2	Lease
FGUP VO Bezopasnost*	**2,428**	**Aleksandra Solzhenitsyna St, 7**	**B+**	**Aleksandra Solzhenitsyna St, 7**	**Lease**
Shire	2,402	Demidov	A	Timura Frunze St, 15	Lease
Perekrestok	2,400	RTS	B+	Sr. Kalitnikovskaya Passage, 26/27	Lease
Hogan Lovells	2,212	Summit	A	Tverskaya St, 22	Lease
Komatsu*	**2,125**	**Diapazon**	**B+**	**1st Volokolamskiy Passage, 10**	**Lease**
CARCADE*	**2,123**	**Stanislavsky Factory**	**B+**	**Stanislavskogo St, 21**	**Lease**

* Knight Frank acted as a consultant of the transaction

Source: Knight Frank Research, 2017

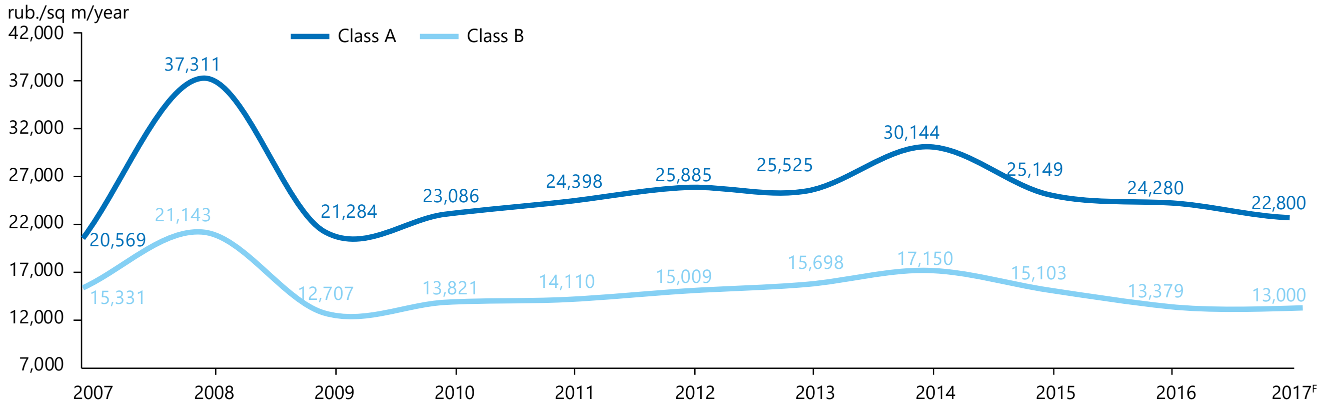
Commercial terms

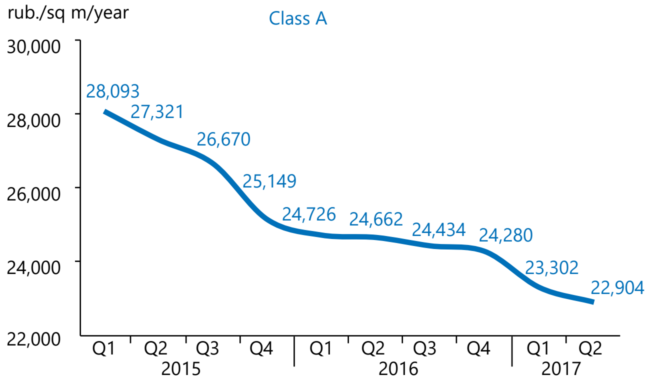
The small increase in the average asking Class B rents recorded in Q1 2017 did not touch Q2 2017: rates began to decline again. This fall came up to 0.7% in H1 2017 and the figure reached a value of 13,289 rub./sq m/ year.

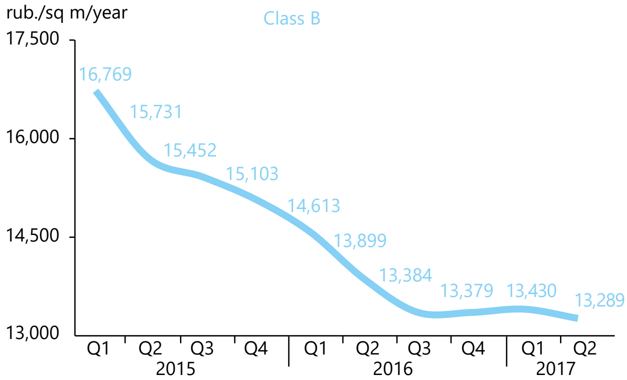
Class A rental rates got on declining and eased to 22,904 rub./sq m/year, almost 6% decrease since the beginning of the year.

Also worth noting is that Class B offices have experienced some stabilization of the average asking rents. The rents have firmed up and quarterly fluctuations have ranged within 1% from the end of 2016 – till H1 2017 after the dramatic rental drop observed from the end of 2014 to mid-2016 with a quarterly reduction speed of 3–6%.

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







Source: Knight Frank Research, 2017

MIBC Moscow-City

Forecast

We expect that office centres planned for delivery in H1 will be commissioned till the year end as well as projects previously planned for commissioning in the second half of the year. However, the aggregate annual volume of the new supply will not exceed 250 thousand sq m hitting the new anti-record level.

It is expected that the Class B vacancy rate will continue to decline till 13.7% by the end of 2017. At the same time, the vacancy for Class A offices will increase insignificantly till 20.9% due to the commissioning of new properties.

The average rents for quality office space in Moscow will settle down until the end of the year, and possible fluctuations will be 2–3% against H1 2017 level.

In general, we do not see significant changes in the office market by the end of the year; it shall be similar to its beginning in terms of key indicators and trends.

Moscow submarket data. Key indicators

Submarket		Lease area, thousand sqm	Class A Average rent* $/sq m/year		Class A Average rent* rub./sq m/year		Class A Vacancy rate, %		Class B Average rent* $/sq m/year		Class B Average rent* rub./sq m/year		Class B Vacancy rate, %	
Boulevard Ring	Central business district	712	705		38,774		19.8		455		24,105		9.1	
Garden Ring	South	950	432	452	23,781	24,849	18.0	15.1	378	396	20,036	21,002	11.8	9.8
	West	546	694		38,145		14.9		–		23,014		8.1	
	North	660	–		23,804		10.9		395		20,944		8.2	
	East	401	–		22,360		14.5		294		15,577		13.0	
Third Transport Ring	South	1,263	–	508	–	27,943	–	17.7	–	276	13,259	14,643	9.5	11.4
	West	781	–		24,933		14.8		–		14,345		34.8	
	North	928	505		27,750		22.1		380		20,120		6.4	
	East	1,114	–		20,924		70.1		285		15,107		7.0	
	MIBC Moscow-City	913	523		28,748		16.0		–		–		–	
TTR-MKAD	North	1003	–	353	25,000	19,430	16.3	19.8	–	237	11,977	12,563	12.4	15.9
	Northwest	734	491		27,007		11.2		–		14,749		29.2	
	South	1,412	–		–		–		–		11,035		17.0	
	West	1,966	367		20,178		10.3		250		13,225		14.5	
	Southwest	569	–		18,493		31.8		–		13,097		18.5	
	Preobrazhenskiy	992	–		13,380		63.4		–		11,412		10.7	
Out MKAD	Khimki	266	–	–	11,382	11,631	24.9	43.5	–	–	6,552	8,196	27.3	22.4
	West	388	–		13,504		70.4		–		9,137		24.0	
	New Moscow	278	–		11,155		36.9		–		6,354		9.7	
Total		**15,876**	**416**		**22,904**		**19.1%**		**251**		**13,289**		**14.1%**	

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

Source: Knight Frank Research, 2017

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