RESEARCH

2016

OFFICE MARKET REPORT

Moscow

HIGHLIGHTS

The Class A and B new delivery volume of 2016 hit new lows for the past 10 years at the level of 317 thousand sq m.

The end of 2016 was marked by 20.7% of the Class A vacancy rate and by 15.4% in Class B offices.

The 2016 take-up level of Class A and B premises amounted to 564 thousand sq m exceeding half as much year-on-year.

Konstantin Losiukov
Director, Office Department
Knight Frank

"The office real estate market continued to adjust to economic shocks in 2016 due to the change in oil prices and the introduction of sanctions. The companies adhered to the optimization strategy of rental costs by moving to a new office or renegotiating the lease terms during the year. The landlords actively made concessions in negotiations, trying to retain existing tenants and attract new ones. As a result, the market showed signs of stabilization by the year end: the vacancy rate decreased against the record low delivery volume, and rents drop nearly ceased.

Today, when the economy nears the phase of recovery growth, there are reasons to believe that the office real estate market will continue hardening in 2017, moving along the path of restoration of the supply and demand balance".

OFFICE MARKET REPORT MOSCOW

Key indicators. Dynamics*

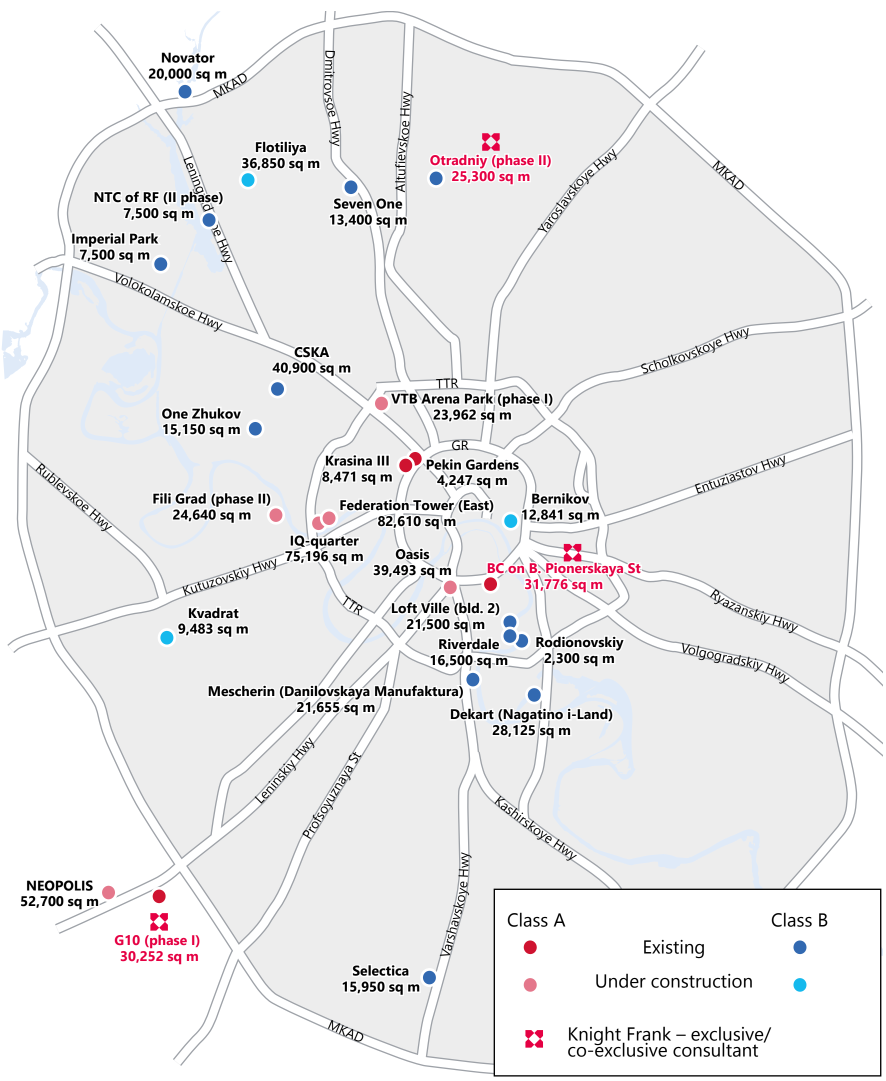
		Класс A	Класс B
Total stock, thousand sq m		15,855	
including, thousand sq m		3,891	11,964
New delivery volume in 2016, thousand sq m		317	
including, thousand sq m		70	247
Net take-up, thousand sq m		564	
including, thousand sq m		308	256
Vacancy rate, %		20.7 (-3.7 p. p.)*	15.4 (-1.1 p. p.)*
Average weighed asking rental rate**	USD/sq m/year	441 (-7.0%)*	252 (-11.6%)*
	RUR/sq m/year	24,280 (-3.5%)*	13,379 (-11.4%)*
Rental rates range**	USD/sq m/year	300–850	250–650
	RUR/sq m/year	8,500–45,000	6,000–35,000
Indexation, %		RUR lease contracts: 7–8% USD lease contracts: 2–3%	
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, 2017

G10, 1 km from Kievskoye hwy

Key office projects delivered in 2016* and due to be commissioned in 2017



* Office properties that received the delivery act in 2016

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

Source: Knight Frank Research, 2017

Supply

The total supply of quality office space in Moscow reached 15.9 million sq m at the end of 2016, where 25% corresponded to Class A and 75% to Class B.

The 2016 delivery volume hit new lows for the past 10 years: 317 thousand sq m were put into operation, which is 56% and 77% lower than in 2015 and 2014, respectively. The Class A delivery also reached the historical bottom value: only 3 office buildings with a total area of 70 thousand sq m were commissioned in 2016 (Na Bolshoy Pionerskoy and Krasina III business centres and G10 Business Park).

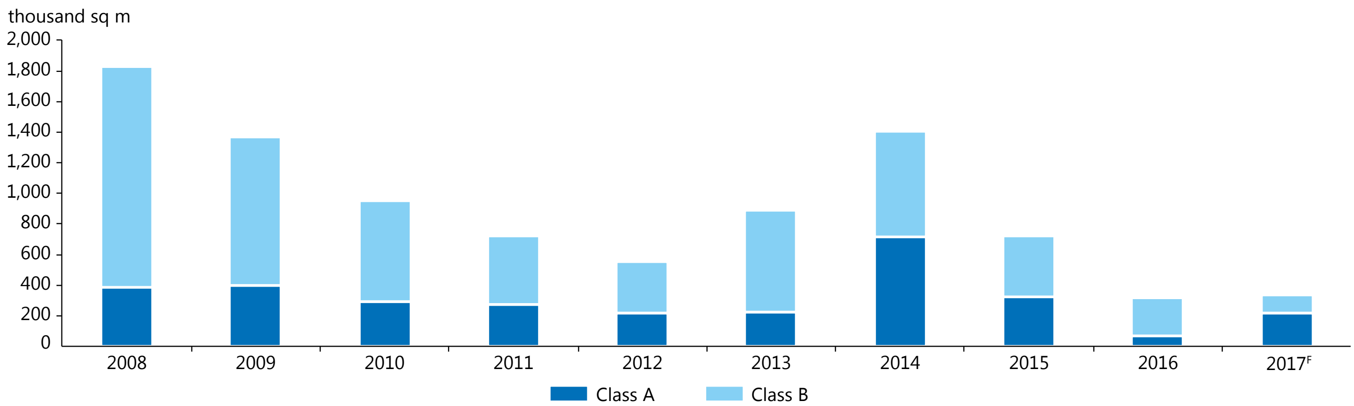
There are still 2.6 million sq m available to tenants and buyers despite declining volume of new construction within the last two years. However, this volume is uneven: central business districts are characterized by a shortage of supply, while the offices in remote business locations remain vacant.

Demand

The tenants moved from lower class properties to higher ones shaping the demand for quality offices of Moscow in 2016. Therefore, the Class A and B vacancy rate decreased from the year-earlier period. The total take-up volume of 2016 both in Class A and B was 564 thousand sq m exceeding half as much year-on-year.

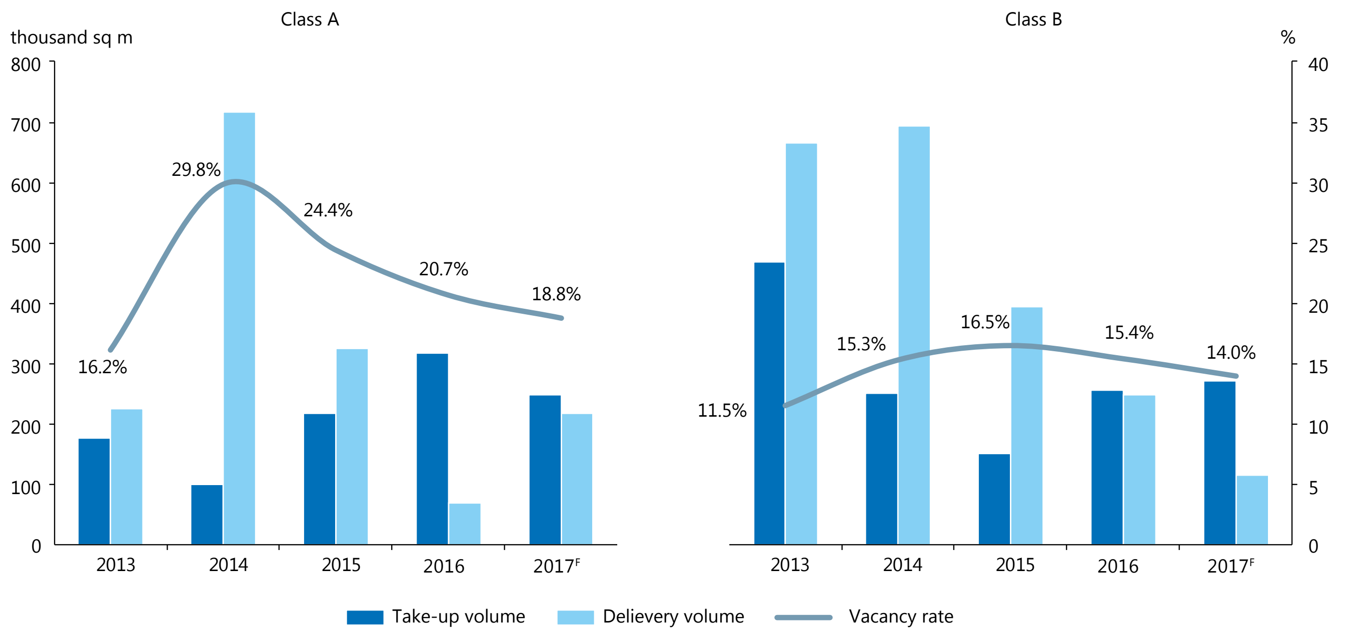
The Class A take-up level increased fourfold resulting in the vacancy rate reduction by 3.7 p. p. and equaled to 20.7%. 65% of this amount was formed by transactions when office buildings were transferred to lending banks. The Class B vacancy rate shrank 15.4%, 1 p. p. less than in 2015.

Class A and B new delivery volume dynamics



Source: Knight Frank Research, 2017

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



Source: Knight Frank Research, 2017

Tenant mix and distribution of transactions by type and location

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

Source: Knight Frank Research, 2017

Thus, the take-up rate slightly exceeded the delivery level and reached the total of 256 thousand sq m.

The activity of office tenants was fuelled by the desire to optimize rental costs. However, in 2015 the financial side of the question was primarily settled, while in 2016 the companies sought to improve the quality of the leased space and its location: as of year-end the share of purchase and new lease transactions was 65% against 44% in 2015.

An increased demand for office space with a central location was the result of falling rental rates in the business centres of the capital: the share of lease transactions within the Garden Ring was up from 18% to 33% in the past year. The remaining volume of leased space accounted for office centres located close to the Third Transport Ring as well as the area between the Third Transport Ring and the Moscow Ring Road. Today, when companies decide to move to new office, they choose the location where they can provide parking lots for employees due to the initiatives of city officials to expand paid parking area.

The new lease was the most popular among high technology, media and telecommunications companies as well as manufacturing companies. Representatives of these fields have traditionally been one of the main consumers of quality office space. The share of companies with state participation has been stable at the level of around 35% in the total volume of purchase and lease transactions for the past 2 years. They are second to none in terms of relocating to new offices and profit from favourable market conditions to consolidate their leased office space.

The average size of lease transactions was 15% down against 2015 and reached 1,472 sq m at year-end 2016. This downturn is caused

Key lease and purchase transactions closed in 2016

Company	Area, sq m	Office building	Class	Address	Transaction type
VTB	86,834	Eurasia Tower	A	12 Krasnopresnenskaya Emb	Sale
Moscow City Government	55,123	Oko	A	21 Krasnogvordeyskiy 1-st Passage	Sale
RUSAL	15,351	Park Pobedy	B+	1 Vasilisi Kozhinoy St	Sale
Yandex	10,333	Aurora Business Park	A	1 bld 77 Sadovnicheskaya Emb	Lease
Samsung	10,000	Novinskiy Passage	A	31 Novinskiy Blvd	Lease
CDIIS (Transneft)	9,000	Ina House	B+	2 Pavlovskiy 3-rd Lane	Lease
Miratorg	8,542	Lotos	A	2 Odesskaya St	Sale
Sberbank	8,500	Danilovskaya Manufaktura	B+	9 Varshavskoye Ave	Lease
Rosenergoatom*	8,449	Port Plaza	B+	6 Proektiruemiy Passage №4062	Lease
Gazprom-Media Holding	7,991	Vereyskaya Plaza III	B+	134 bld 29 Vereyskaya St	Lease
PRO GRES	7,300	Gazoil Plaza	B+	43 Khersonskaya St	Lease
Alma Group	7,300	Mercury City	A	15 Krasnogvordeyskiy 1-st Passage	Lease
Rybakov Foundation	6,712	VTB Arena Park	A	32 Leningradskiy Ave	Sale
585 GOLD*	6,114	1 bld 17 Zubovskiy Blvd	B+	1 bld 17 Zubovskiy Blvd	Sale
Ancor	6,000	Golden Gate	B+	2 Entuziastov Blvd	Lease
Servier	5,982	White Gardens	A	7 Lesnaya St	Lease
Sinergy	5,320	Golutvinskiy Dvor	A	2 Yakimanskaya Emb	Lease
BINBANK	5,100	Dominion Tower	A	5 bld 1 Sharikopodshipnikovskaya St	Lease
Ipsos*	5,100	Krasnoselskiy	B+	3 bld 2 Verhnaya Krasnoselskaya St	Lease
Engeocom	5,000	1,2 bld 24 Pogodinskaya St	B+	1,2 bld 24 Pogodinskaya St	Lease

* Knight Frank acted as a consultant of the transaction

Source: Knight Frank Research, 2017

by the reduction of the number of major lease transactions: 41% of the total volume of leased space was comprised of ten large transactions, while this share went down by 22% as of the end of 2016.

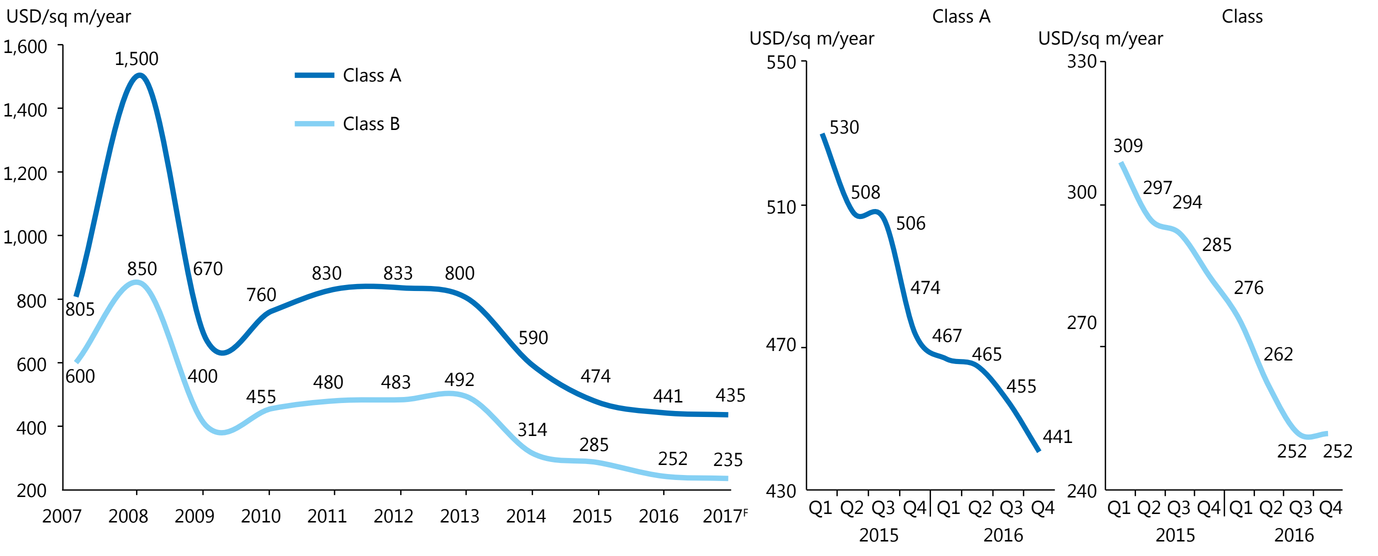
Commercial terms

The Class A rental rates stayed stable during the year except for properties with high vacancy rate. Their landlords moved on reducing asking rates. At the same time a slight increase in rents was recorded in some premises. For example, the average rents for office buildings located in MIBC Moscow City increased by 11% compared with Q4 2015: its vacancy rate decreased and reached 18% against 29% at the end of 2015 after the completion of several large transactions. Therefore, a number of landlords revised commercial terms upward. The average rental rate of Class A offices was 24,280 RUR/sq m/year at the end of 2016, down by 3.5% year-on-year.

The average Class B rental rates decreased by 11% for the year going down to 13,379 RUR/sq m/year. The landlords of Class B offices were the most active to reduce rates in the first three quarters: the decline ranged from 3% to 5%. The smallest drop was observed in Q4: the rental decline was offset by a withdrawal of some units with low rates from the market.

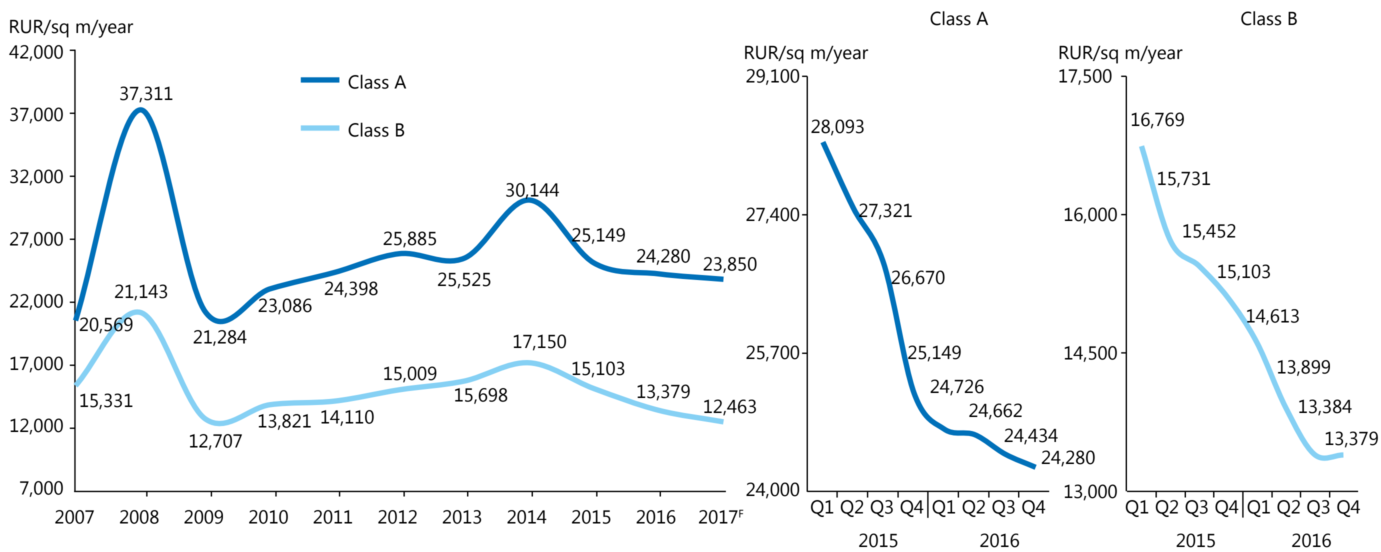
The lease agreements are mostly concluded for a period of 3–5 years with the Russian ruble finally becoming the dominant currency of the lease. The rental indexation is still subject to negotiations as the inflation pace linked to this value in ruble agreements demonstrates significant fluctuations in the past two years: 2015 CPI was 12.9% falling to 5.4% in 2016. The inflation will be at the level of 4% in 2017 according to the forecast of the Ministry of Economic Development.

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



Source: Knight Frank Research, 2017

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



Source: Knight Frank Research, 2017

Forecast

700 thousand sq m are currently under construction where 330 thousand sq m are announced for commissioning in 2017. But the real commissioning volume may be lower if the market trend will continue when the landlords transfer the delivery for an indefinite period in order to avoid the tax burden increase due to commissioning. In the next two years, the development activity will remain low, new projects are announced by fewer landlords.

Russia's GDP will be trending upward in 2017 for the first time since the crisis according to the macroeconomic forecast for the country's development. The Ministry of Economic Development expects an increase in GDP to the level of 0.6% per year. As there are still some economic constraints for expansion of demand, we expect that the take-up amount will remain at the current level in 2017, i.e. circa 500–600 thousand sq m.

Asking rental rates will remain 2016 level and the change of supply structure and commercial policies of individual landlords will be the factors influencing the adjustment of the weighted average. As a result, the rental rates in very much sought after business districts will show growth, while the rental decline will proceed in less popular business locations.

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	852		46,004		22.2		456		24,169		9.2	
Garden Ring	South	950	454	480	25,081	25,698	20.7	18.4	515	403	27,295	21,362	11.1	11.2
	West	286	–		35,813		17.9		–		23,492		14.6	
	North	660	–		23,475		17.1		374		19,825		6.4	
	East	401	–		24,253		14.6		–		15,886		17.7	
	Khamovniki	260	666		36,641		15.5		–		24,809		6.4	
Third Transport Ring	Leninskiy	278	–	547	–	29,240	–	18.1	–	287	15,728	15,038	15.5	13.9
	Tulskiy	985	–		–		–		–		13,685		11.2	
	Kievskiy	424	–		23,451		15.5		–		13,558		46.9	
	Presnenskiy	357	–		24,661		5.7		–		17,996		10.9	
	Prospekt Mira	162	–		–		–		–		19,038		54.4	
	Tverskoy-Novoslobodskiy	752	563		30,941		22.4		376		19,921		10.7	
	Basmanniy	326	–		–		–		–		13,886		5.0	
	Taganskiy	175	–		–		–		330		17,505		13.9	
	Volgogradskiy	418	–		–		–		–		14,523		19.6	
	Lefortovo	195	–		–		–		–		14,128		12.4	
	MIBC Moscow-City	913	523		28,739		18.4		–		–		–	
TTR-MKAD	North	627	–	347	25,000	18,495	12.7	22.3	–	237	12,517	12,539	18.9	16.2
	Northwest	692	448		24,647		12.2		–		14,718		21.0	
	South	1,152	–		–		–		–		10,076		16.6	
	West	565	–		–		–		305		16,139		13.5	
	Southwest	626	–		17,838		34.4		259		13,650		17.1	
	East	453	–		–		–		–		8,555		8.3	
	Preobrazhenskiy	291	–		12,112		60.2		–		14,715		23.0	
MKAD	North	376	–	252	–	13,463	–	31.6	–	–	7,122	8,897	17.8	19.0
	Northwest	308	–		10,835		45.7		–		6,777		26.6	
	South	260	–		–		–		–		9,783		36.3	
	West	1,789	304		16,728		20.9		–		10,309		18.7	
	Southwest	215	–		12,664		37.9		–		7,182		14.8	
	East	248	–		–		–		–		3,237		0.8	
Total		**15,855**	**441**		**24,280**		**20.7**		**252**		**13,379**		**15.4**	

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

Source: Knight Frank Research, 2017

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