RESEARCH

Q1 2015

# OFFICE MARKET REPORT

Moscow

## HIGHLIGHTS

Delivery volume of quality office space in Q1 2015 was 91 thousand sq m that is 60% drop compared to the previous year indicator.

Share of lease renegotiations in the total transactions volume has reached 86%.

Average asking rental rates have dropped to the level of 530 $/sq m/year in Class A and 309 $/sq m/year in Class B offices.

# OFFICE MARKET REPORT MOSCOW

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*"With declining take-up and record-high vacancy rate, today's office real estate market is characterized by extremely fierce competition. Landlords are seeking to offer the most favourable lease terms, but only high-quality offices in a good location with efficient layout and attractive commercial terms are in demand.*

*As rental rates are falling, the lease renegotiation has become the dominant type of transactions in the Moscow office real estate market. There are examples where companies that signed lease contracts last year renegotiate them in 2015 to reduce rents or revise other lease terms. "*

Key indicators. Dynamics*

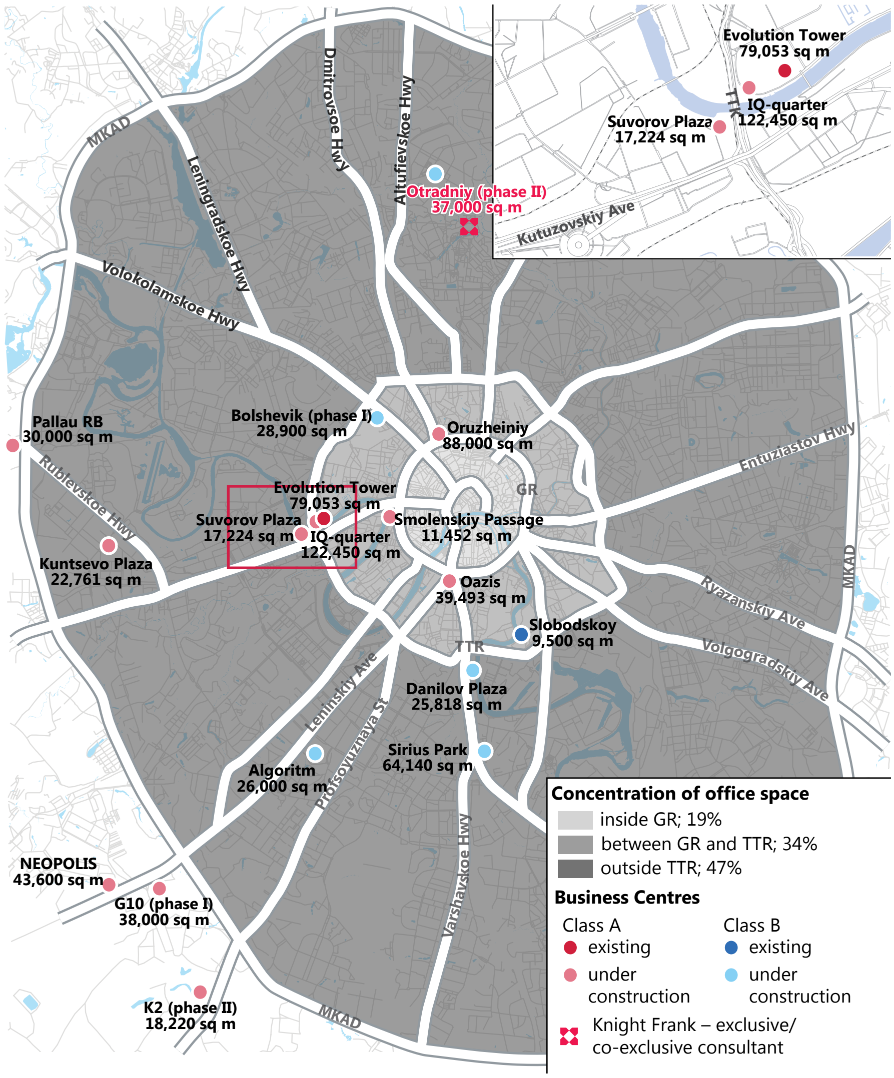
| | | Class A | Class B |
|---|---|---|---|
| Total stock, thousand sq m | | 14,852 | |
| including, thousand sq m | | 3,495 | 11,358 |
| Delivered in Q1 2015, thousand sq m | | 90.7 | |
| including, thousand sq m | | 79 | 11.7 |
| Vacancy rate, % | | 29.0 (-0.8 p. p.)* | 16.7 (+1.4 p. p.)* |
| Average weighed asking rental rate** | $/sq m/year | 530 (-10%)* | 309 (-10%) |
| | rub/sq m/year | 27,093 (-10%)* | 16,769 (-2%)* |
| Rental rates range** | $/sq m/year | 300–1,000 | 250–970 |
| Average OPEX rate, | rub/sq m/year | 4,000–6,700 | 2,500–4,500 |

* Compared to Q4 2014
** Excluding operational expenses utility bills and VAT (18%)

Source: Knight Frank Research, 2015

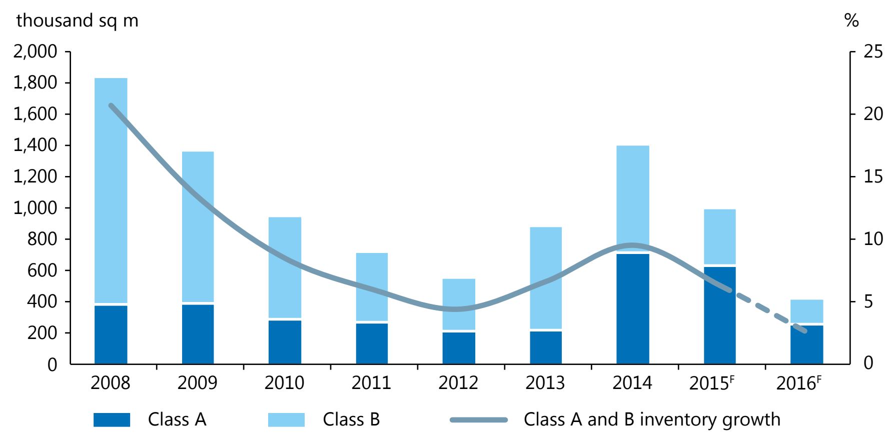
Otradniy (phase II), 2B, Otradniy passage

Key office projects delivered in Q1 2015 and due to be commissioned by the end of 2015




* Office properties that received the delivery act in Q1 2015
The building class is indicated according to the Moscow Research Forum Office Classification of 2013
Source: Knight Frank Research, 2015

Delivery volume dynamics for Class A and B offices




Source: Knight Frank Research, 2015

## Supply

In Q1 2015, the total supply of high-quality office space in Moscow has reached 14.8 million sq m, with Class A and Class B offices accounting for 3.5 million sq m and 11.3 million sq m, respectively.

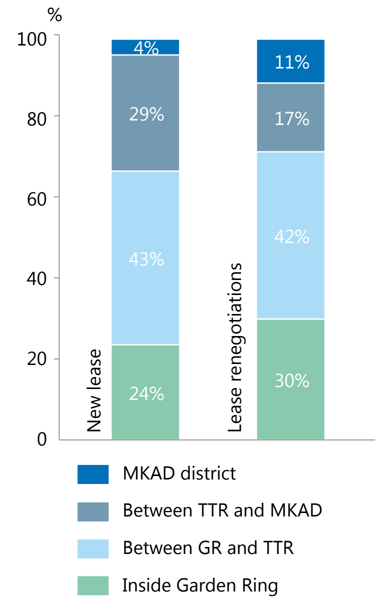
After decrease in supply in 2014, the delivery of new office space dropped 60% in Q1 2015 year-on-year, to just over 90,000 sq m. The Evolution Tower in the Moscow City business center was the only Class A office building delivered in Q1 2015.

## Demand

The net take-up of quality offices in Moscow was 37,000 sq m in Q1 2015, 20% below the same period last year.

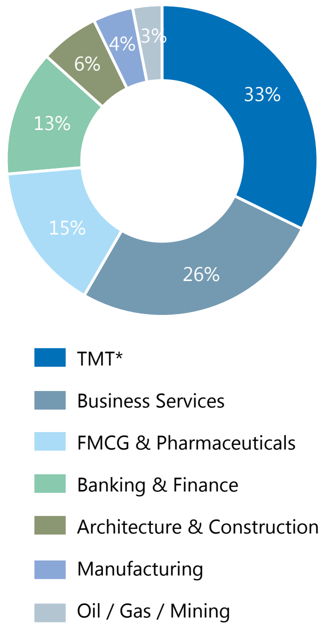
Lease renegotiation is the dominant type of transactions in the current market environment. Tenants having foreign currency agreements start renegotiating the lease terms to fix the exchange rate for the period of 1–2 years. Apart from changing the contract currency, tenants who signed lease contracts in a stable or growing market also seek to reduce their rental rents. As a result, lease renegotiations has totalled 86% of all transactions in Q1 2015.

Distribution of deals by location




Source: Knight Frank Research, 2015

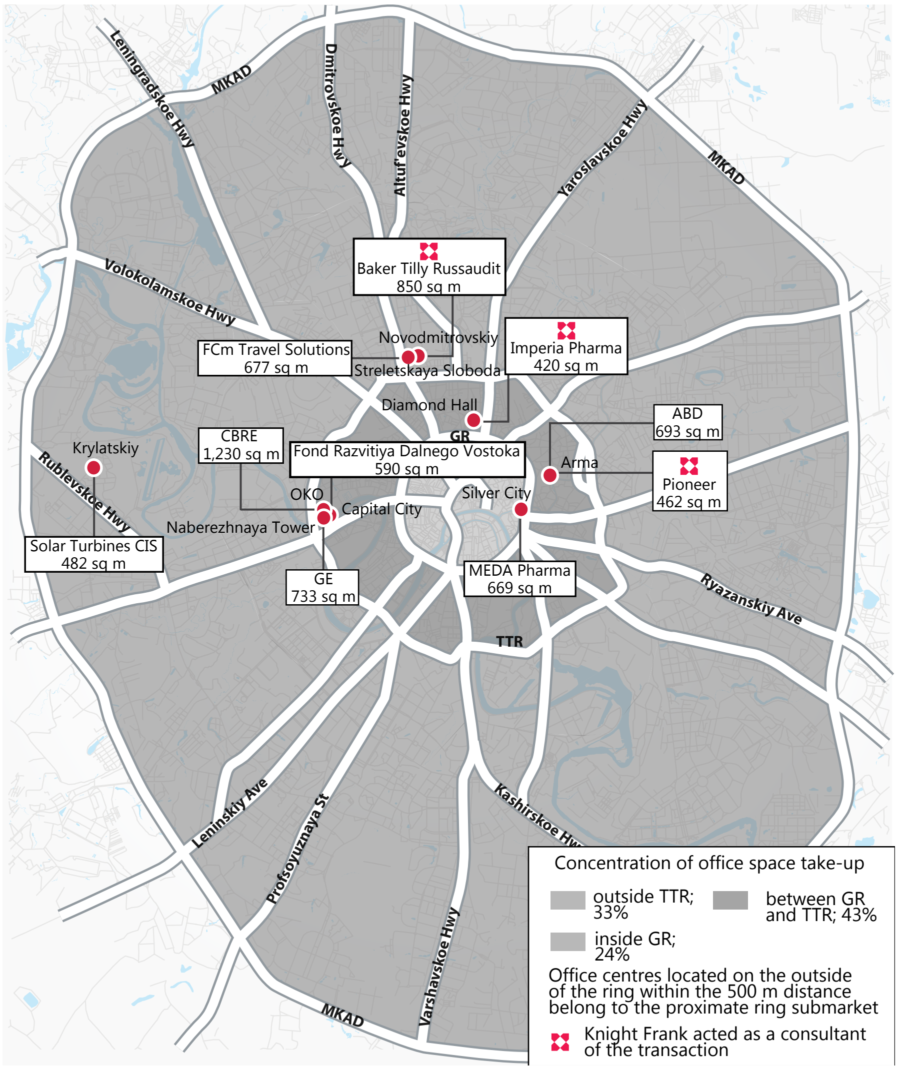
## Tenant mix




* TMT – technology, media and telecommunication

Source: Knight Frank Research, 2015

## Key office space lease and purchase transactions closed in Q1 2015



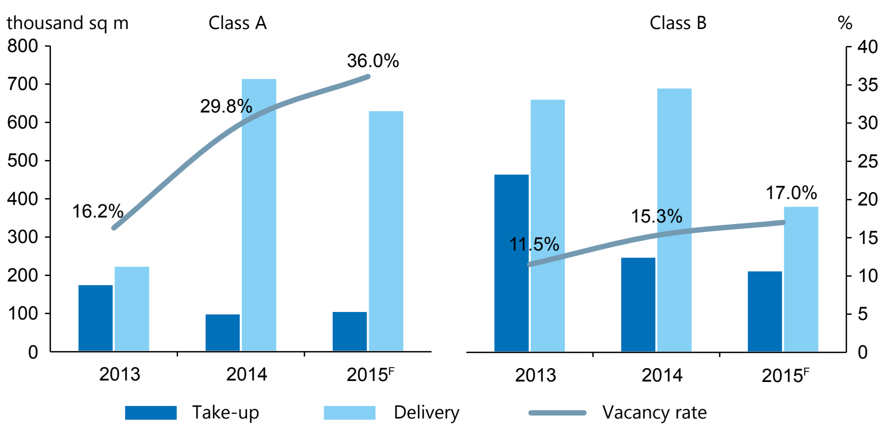

Source: Knight Frank Research, 2015

Vacancy rate, which had been rising throughout 2014, totaled 29% for Class A office buildings in Q1 2015. The vacancy rate in the Class B office market was 16.7%.

Since 2013, there has been a tendency for companies seeking to reduce rental costs and move to higher-quality premises, which made them look for office space near the Moscow Ring Road. However, the falling market has changed the direction of this decentralization trend. Businesses are still keen to reduce rental costs and mostly consider offices outside the Garden Ring. However, with the rents falling, they can afford less distant options with rates almost the same as the ones for offices of similar quality near the Moscow Ring Road: properties located near the Third Transport Ring accounted for the largest number of office lease deals (43%) in Q1 2015.

As for the distribution of demand by company type, the largest volume of lease and sales transactions across Class A and B offices was completed by TMT companies, which had been among the key occupiers of high-quality office space in Moscow for a long time. In the current environment, when the number of deals is low, the market share of one or another tenant or buyer type does not give an objective

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




Source: Knight Frank Research, 2015

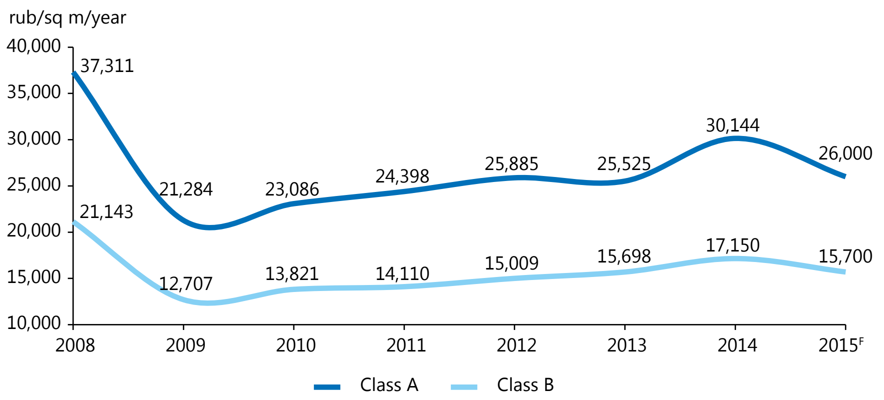
picture. Nevertheless, we can point out that the highly volatile oil prices and the sanctions against the Russian economy translated into oil and gas companies and banking businesses accounting for only a small proportion of the demand.

## Commercial terms

The weighted average rental rate in the Class A office market, which is calculated on the basis of asking rental rates for vacant office space, went down by 10% from the previous quarter, to 27,093 rub/sq m/year (triple net). For the Class A offices with US dollar-denominated rents, the decrease was also about 10%, to 530 $/sq m/year (triple net). For Class B offices, the asking rents have decreased to the level of 16,769 rub/sq m/year (triple net), or 309 $/sq m/year (–10%).

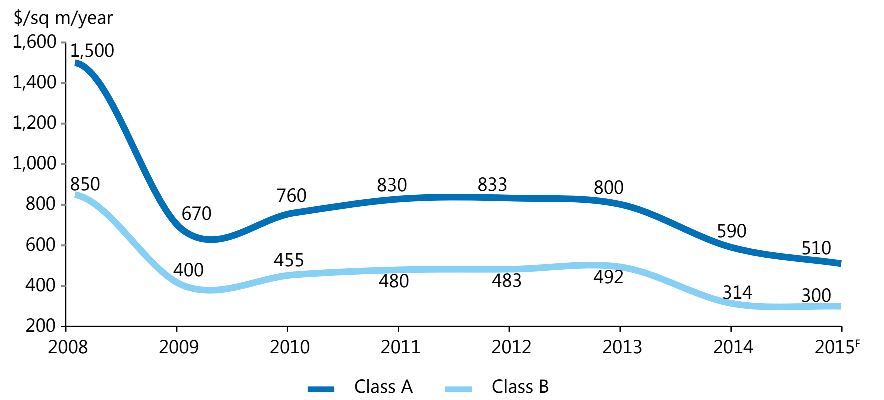
Today a large number of landlords are ready to surrender and propose rental rates in rubles, fixing the exchange rate and providing a currency band. However, a few owners of Class A offices are ready to revise the commercial terms for the entire duration of the contract: just 12% of Class A vacant office premises were available on such terms as of the end of Q1 2015. More often, landlords agree to provide rental rates fixed in Russian national currency for the first two years, after which they are planning to switch back to a foreign currency.

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




Source: Knight Frank Research, 2015

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




Source: Knight Frank Research, 2015


G10 business park, 1st km of Kievskoe Hwy

## Forecast

Despite the recent stability of the Russian ruble and oil prices, office market players are still very cautious. Almost 1 million sq m of quality office space is due to be delivered in 2015; however, most likely, the current state of the office market will force the developers to hold over the deadlines. We do not expect the owners to put on hold construction of the projects scheduled for delivery by the end of the year, but the current environment will probably make them suspend those that are at the initial construction or project stages.

It should be noted that about 130,000 sq m of office space is expected to be delivered in 2015 in the territory of New Moscow near MKAD. A number of construction projects in this area were announced in 2012, after the Moscow territorial expansion plan has been unveiled. However, with the current state of the office market, the landlords are likely to open these properties without having lease contracts signed.

A similar situation is observed in the Moscow City business district, where almost half of the office space remains vacant. In 2015, the vacancy rate in this district will continue increasing, because, as reported earlier, 200,000 sq m of Class A office space is due to be completed in 2015 in addition to the 200,000 sq m delivered in 2014.

As the market is still unstable, the volume of transactions will be mainly formed by lease renegotiations, with the net take-up remaining at a low level. Taking into account the volume of offices to be delivered in 2015, the vacancy rate will continue rising. We estimate that for Class A offices this figure may exceed 35% by the end of the year.

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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, % | |
| | | | $/sq m/ year | | rub/sq m/ year | | | | $/sq m/ year | | rub/sq m/ year | | | |
| Boulevard Ring | Central business district | 712 | 940 | | 49,795 | | 14.9 | | 387 | | 20,509 | | 10.0 | |
| Garden Ring | South | 918 | 529 | 573 | 28,019 | 30,357 | 21.3 | 15.6 | 457 | 472 | 24,245 | 24,930 | 10.0 | 13.0 |
| | West | 273 | 916 | | 48,540 | | 8.1 | | 532 | | 28,190 | | 7.0 | |
| | North | 560 | 769 | | 40,733 | | 6.4 | | 598 | | 31,363 | | 11.0 | |
| | East | 401 | 511 | | 27,107 | | 18.8 | | 407 | | 21,586 | | 20.0 | |
| Third Transport Ring | Leninskiy | 270 | 528 | 639 | - | 33,881 | 9.1 | 36.0 | 419 | 396 | 22,194 | 20,992 | 25.0 | 15.0 |
| | Tulskiy | 900 | - | | - | | - | | 390 | | 20,669 | | 15.1 | |
| | Khamovniki | 260 | 980 | | 51,949 | | 20.7 | | 592 | | 31,381 | | 1.7 | |
| | Kievskiy | 393 | 472 | | 25,000 | | 100.0 | | 487 | | 25,791 | | 58.0 | |
| | Presnenskiy | 357 | 448 | | 23,729 | | 7.3 | | 500 | | 26,509 | | 7.1 | |
| | Prospekt Mira | 160 | 483 | | 25,583 | | 34.6 | | 298 | | 17,825 | | 16.0 | |
| | Tverskoy-Novoslobodskiy | 738 | 828 | | 43,905 | | 19.5 | | 403 | | 21,340 | | 4.5 | |
| | Basmanniy | 502 | - | | - | | - | | 352 | | 18,645 | | 16.0 | |
| | Taganskiy | 227 | 450 | | - | | 82.9 | | 218 | | 11,575 | | 14.0 | |
| | Volgogradskiy | 383 | - | | 30,000 | | 48.0 | | 278 | | 14,736 | | 3.0 | |
| | MIBC Moscow-City | 803 | 618 | | 27,458 | | 44.2 | | | | | | | |
| TTR-MKAD | North | 659 | 598 | 476 | 31,696 | 25,238 | 1.9 | 23.3 | 221 | 279 | 11,737 | 14,779 | 19.0 | 16.0 |
| | South | 1,634 | 473 | | 25,058 | | 51.7 | | 262 | | 13,878 | | 18.0 | |
| | West | 1,164 | 526 | | 27,857 | | 16.3 | | 381 | | 20,184 | | 13.0 | |
| | East | 649 | 404 | | - | | 49.3 | | 249 | | 13,199 | | 12.0 | |
| MKAD | North | 525 | - | 314 | - | 16,634 | - | 35.2 | 177 | 214 | 9,400 | 11,358 | 17.0 | 23.0 |
| | South | 413 | 336 | | 17,810 | | 66.8 | | 171 | | 9,057 | | 18.0 | |
| | West | 1,703 | 310 | | 16,409 | | 28.0 | | 245 | | 12,977 | | 30.0 | |
| | East | 248 | - | | | | | | | | | | | |
| **Total** | | **14,852** | **530** | | **27,093** | | **29.0** | | **309** | | **16,769** | | **16.7** | |

Source: Knight Frank Research, 2015