OVERVIEW

2011

RETAIL REAL ESTATE MARKET

Moscow

Knight Frank

EXECUTIVE SUMMARY

- In 2011 the supply of retail space in Moscow increased by about 320 thousand sq m, it's a record-low increase for the last ten years.
- Market decentralization has continued: limitations on new development in the central Moscow focused developers attention on remote districts of the capital and suburban areas.
- In Moscow, as well as in many towns of the region, retail projects stalled by the crisis have now been restarted, including many chain projects. A number of new projects have been announced.
- Developers increasingly focus on redesigning and redeveloping retail objects that have become outdated or had serious flaws in the concept.
- Many retailers pursued aggressive expansion through both new retail stores in their existing cities and expansion into new regions. One of the key drivers behind corporate development strategies was to improve retail chain performance.

RETAIL REAL ESTATE MARKET. MOSCOW

Sergey Gipsh,
Regional Retail Director,
Partner
Knight Frank

"Our forecast for retail real estate market in 2011 has proved very accurate. As expected, during the whole year the market was driven by two key factors: very low growth of supply and high retail activity, which resulted in a shortage of modern retail area, decrease in vacancy rates and increase in rental rates. In 2012, we expect this trend to slow down due to significant amounts of new supply come to the market. In particular, a number of outlet centres are scheduled to be opened – which is a new concept for the Russian market. In addition, it is likely that there will be more redesign and redevelopment projects – these primarily include shopping centres that have become outdated or had serious flaws in the concept from the beginning and that will not otherwise be able to compete with new high quality projects."

Main indicators. Shopping centres*		Trend
Total supply at operating centres (total area / GLA**), mln sq m	7.83 / 4.25	↑
Opened in 2011 (total area / GLA), mln sq m	0.32 / 0.21	
Scheduled to open in 2012 (total area / GLA), mln sq m	0.96 / 0.44	
Vacancy rate, %	2.5	↓
Base rent, $ per sq m per annum (not including operating expenses and VAT)		
anchor tenants	100 - 500	↑
retail gallery tenants***	700 – 4,000	↑
Operating expenses, $ per sq m per annum	80 - 260	→
GLA in quality shopping centres per 1,000 population (Moscow)	370	→

* The table refers only to high quality, professional shopping centres. A professional shopping centre is a standalone building or a group of buildings sharing the same architectural style, concept and under common management, with a total area of more than 5,000 sq m

** Gross leasable area

*** Applicable to stores of approximately 100 sq m located on the ground floor

Source: Knight Frank Research, 2012

The enabling business environment in early 2011 provided an impetus for economic growth in Russia. Personal loan rates declined, causing consumer lending sector to grow (18% in the first six months), which spurred consumer spending amid continuing inflationary pressure. After a "post-crisis" austerity period in 2009-2010 when household savings ratio was 15%, in first half of 2011 consumer spending patterns showed a trend towards the "pre-crisis" level, pushing savings ratio down to 10.3%.

As reported by the Ministry of Economic Development, during the period from January through November 2011 retail turnover increased by 8.6% over the same period the previous year. However since the autumn, growth rates have started to slow down across basic economic performance indicators, including retail turnover rate: in November it increased by only 0.1%. Retailers however are optimistic about 2012; they do not expect any significant reductions in consumption, which is reflected in their ambitious network expansion plans.

Main events

- In 2011 the Moscow Government continued revisiting its 1,300 current investment contracts. A decision was taken to "limit or indeed prohibit development in the centre of Moscow". By the end of year about 70% of all open contracts have been revised; as a result, several significant projects with a retail component have been canceled, including large underground development projects under the city's central squares (Paveletsky railway station, Pushkinskaya and Tverskaya Zastava squares).

- In autumn 2011 a decision was taken to renovate the All-Russia Exhibition Centre (AREC) to preserve the historical buildings and build new parkland, sports and exhibition facilities. Co-investors in the project are God Nisanov and Zarah Iliev. As part of the AREC Renewal concept, a dolphinarium, a water park and a 5D cinema will be constructed on the site.

- In 2011 several new retail projects were announced. Trinity Russian Retail Partners (entity formed by the merger of the Canadian Trinity Development Group Inc. and Shenkman Corporation with Russian Retail Partners) has announced its plan to develop four retail park projects: in Kaluzhskoye and Kashirskoye highways and two projects along MKAD. GVA Sawyer intends to build two retail parks in the town of Volokolamsk and in Dmitrovsky District, Moscow Region.

- 2011 saw very high level of investment in retail real estate market: total volume of investment transactions in retail objects in Russia increased tenfold compared to 2010. The largest deals closed during the year in Moscow include the following:

  - Kaluzhsky shopping and entertainment centre was acquired by companies ultimately owned by Mikhail Gutseriev and Mikail Shishkhanov.

  - Shopping centres Gorbushkin Dvor and Filion were acquired by Yuri and Alexei Khotin from MTP Rubin .

  - The IMMOFINANZ group acquired the remaining 25% interest in shopping and entertainment centre GoodZone to become the sole owner of the entire property.

  - Romanov Property Holdings foundation acquired shopping centre Dream House.

  - UFG Real Estate foundation entered into an agreement with Capital Group to acquire assets of BC Pushkinsky Dom, BC Concord and shopping complex Metromarket located in the same building. The remaining three Metromarket properties were bought by RMB Invest fund.

  - Tashir Group announced the acquisition of Arkadi Raikin shopping and entertainment centre project currently under construction. In addition, the group is participating in a new shopping and entertainment centre development project at the intersection of Vernadskogo Ave and Pokryshkina St together with Petro Estate.

- In 2011 several landmark retailer acquisitions were completed, of which the largest was the acquisition by Dixi Group of food store chain Victoria (25.6 bln rubles including debts). X5 Retail Group acquired Kirov-based chains Ekonomnaya Semya and Mir Produktov, and Tatarstan-based chain Narodny (24 stores). Magnit bought 14 stores from Tambov-based discounter chain Pyatachok. In the end of year telecom operator Evroset acquired Sigma Trade, the company operating Alt Telecom mobile phone shops.

- In 2011 new players continued to enter the Moscow retail real estate market, they are: Banana Republic, Victoria`s Secret, Wendy's, Desigual, American Eagle, Imaginarium and others.

Shopping centres opened in 2011

Project	Address	Total area (sq m)	GLA (sq m)
Afimall City	2 Presnenskaya Emb	180,000	114,000
Vitte Mall	Southern Butovo, Bld 7 Venevskaya St	30,000	23,000
Otrada*	Bld 2 Pyatnitskoye Hwy	25,000	22,000
Aventura	Severnoye Chertanovo, Bld 1A	35,000	20,000
Planernaya Interchange	Planernaya m. st.	n/a	11,000
Shopping centre forming part of MonArch mixed-use centre	Bld 1, 31 Leningradsky Ave	16,000	11,000
Severnoye Siyaniye	1 Dmitriya Donskogo Blvd	17,000	10,000

*In December 2011 phase I of Otrada project was commissioned
Источник: Knight Frank Research, 2012

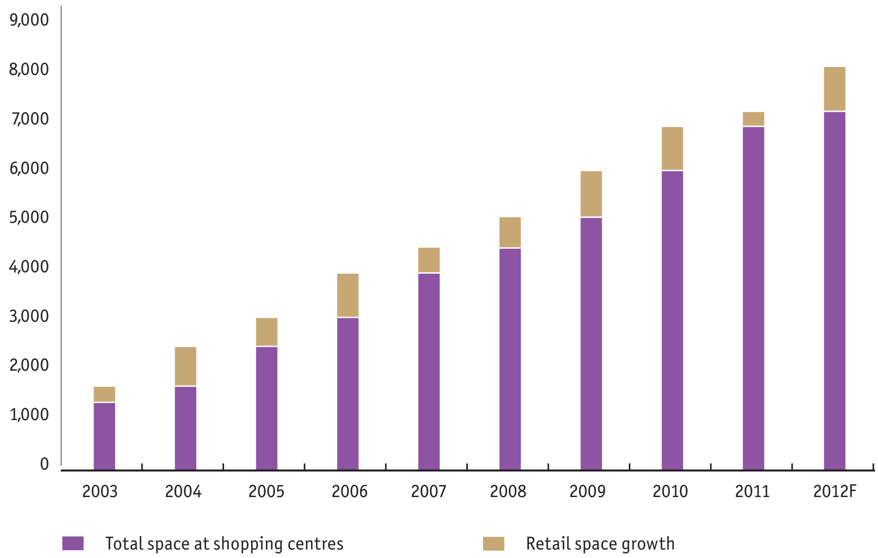
Supply

In 2011 only seven retail objects were commissioned at Moscow market instead of the initially scheduled fifteen.
As a result, the total supply increased by 4.3% or 320,000 sq m (GLA – 210,000 sq m), the record low level in the last ten years in both absolute and percentage terms.
By comparison, in 2010 the supply increased by 961,000 sq m (GLA – 401,000 sq m), and in 2009, by 994,000 sq m (GLA – 578,000 sq m).
It should be noted that new supply mainly consists of "pre-crisis" retail objects.

The enabling business environment in 2010 – early 2011 gave a new impetus to property development: retail projects stalled during the crisis have now been restarted, including many chain projects. For instance, holding Finstroy expects to open new shopping centres under the Vesna! brand in Altufievo district of Moscow (GBA - 126,000 sq m), in the town of Lytkarino, Moscow Region (GBA – 30,500 sq m), in the towns of Smolyensk (GBA – 35,500 sq m) and Saratov (GBA – 45,000 sq m).

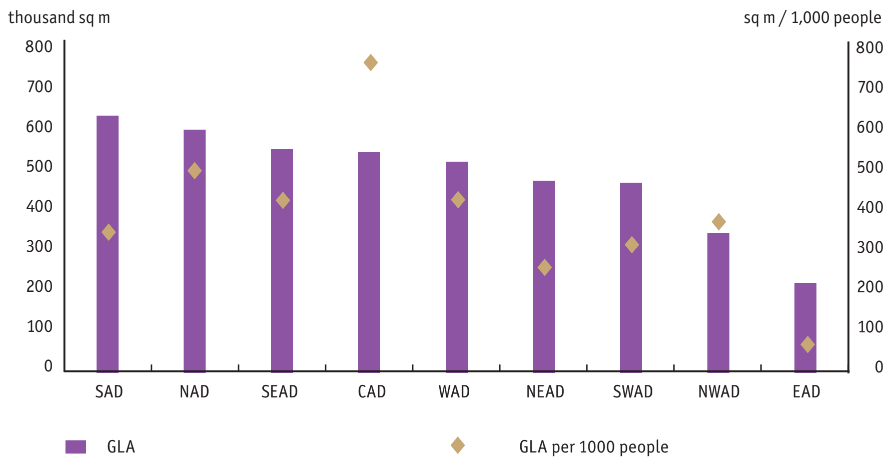
Among all shopping centres opened in 2011 only one – Afimall City – offers a retail area

Retail area supply growth in 2011 was record low in the last ten years
thousand sq m



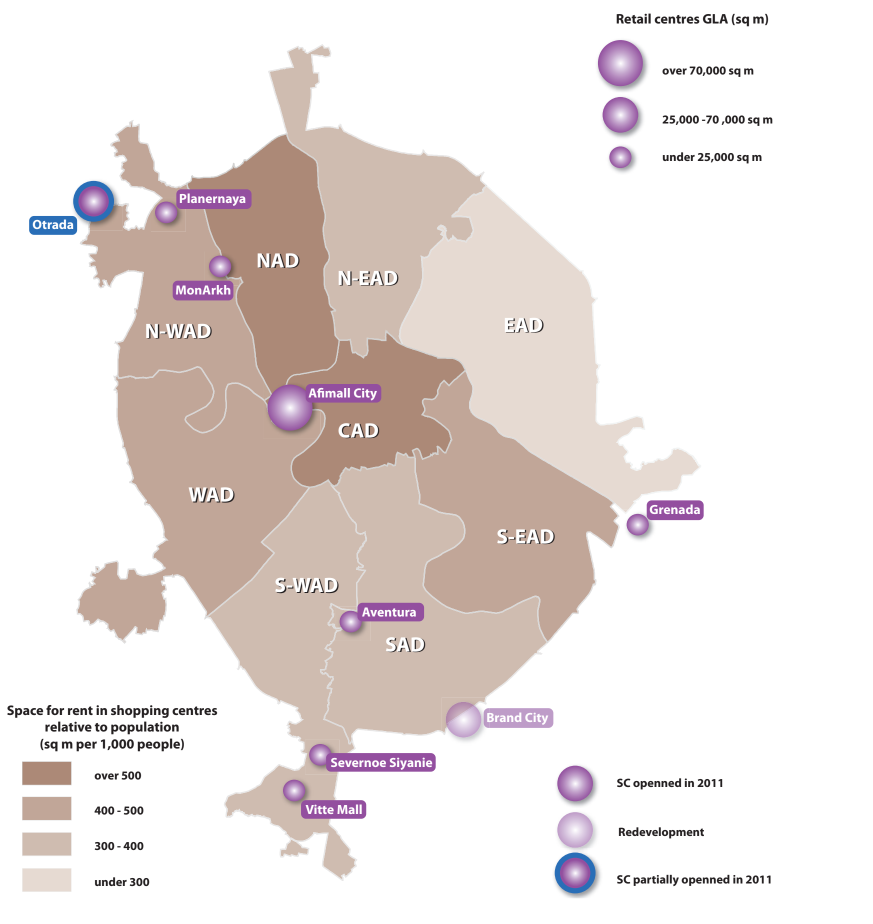
Source: Knight Frank Research, 2012

The Southern administrative district continues to account for the largest proportion of new shopping centres, with over 14.5% of total supply of retail space in Moscow



Source: Knight Frank Research, 2012

Shopping centres opened in 2011. Retail space per 1,000 people ratio, by district, 2011



Source: Knight Frank Research, 2012

of more than 100,000 sq m, and the rest of the properties are neighborhood shopping centres. It is not quite typical for the Moscow retail real estate market as it used to be in the past. Previous years, three or more high quality regional or super-regional shopping centres were commissioning to the market each year. The trend is partly attributable to the fact that the launch of several large projects was postponed to the next year (e.g. shopping and entertainment centres GoodZone, River Mall and others).

So, at the beginning of 2012, the total supply of modern retail space in Moscow reached 7.83 mln sq m (GLA – 4.25 mln sq m). The Southern administrative district continues to account for the largest proportion of new shopping centres entering the Moscow market, with over 14.5% of total supply of retail area in the city. It is followed by the Northern, South-Western, Central and Western districts, each accounting for more than 12% of total supply.
The Eastern district of Moscow has reported the lowest figure of only approximately 200,000 sq m.

The Central District boasts the highest amount of retail space per person: because of a low resident population, it has a ratio of almost 760 sq m of retail area per thousand people (excluding street retail). In contrast, the most densely populated Southern District ranks sixth of the nine districts of the city for this indicator.

The market average retail provision ratio in Moscow is 370 sq m per thousand people, which is far below the European average. On average in Europe, this figure ranges from 500 to 850 sq m per thousand people, and in some cities exceeds 1,000 sq m per thousand people.

The Moscow Government has announced a set of measures to improve the ratio to the European average. In particular, it is proposed to increase the number of neighborhood stores and build small shopping centres with an area of 5,000 to 10,000 sq m). So far, however, the local government's policy to restrict development within the Third Transport Ring does nothing but create a shortage of quality retail area in Moscow.

In these circumstances developers had to redirect their attention to remote districts of Moscow and suburban areas. In August, shopping centre Grenada was commissioned in the town of Lyubertsy, and in December, phase I of Otrada shopping centre was opened near Mitino, Moscow.

Demand

Retailers remained highly active throughout 2011. In the beginning of the year, many of the national and international operators already present in the market have announced large-scale plans to expand their presence. At the end of the year, many reported that they had exceeded their annual targets. For example, food store chain O'key has increased its network by 14 stores instead of 11 as originally planned. Magnit group that has focused on drogerie segment (convenience stores), too, has exceeded its expansion target by 5%. Detsky Mir and Familia chains have resumed their regional expansion. Burger King and Stockmann have expanded into the Yekaterinburg market.

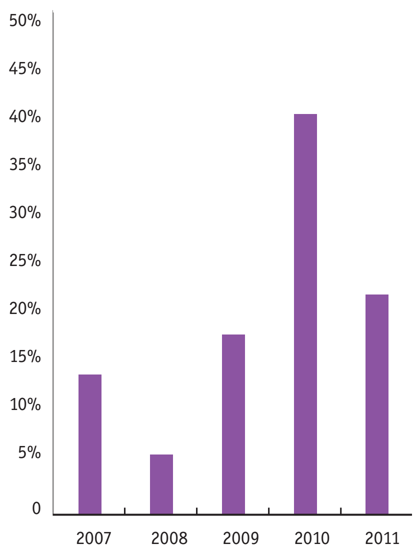
Some international brands that used to operate under a franchise system, have announced their decision to establish a direct presence in Russia, such as Hermes, Prada, Guess and several other operators.

In addition, new entrants in the Russian market include such clothing brands as Banana Republic, American Eagle, Desigual, DC Shoes and others; many of them opened more than one store before the year-end. During the year, the US-based accessories store Victoria's Secret opened three stores in the Moscow's largest shopping centres, and the Spanish chain Imaginarium (children's goods) opened four stores.

Altogether, around 50 international operators have opened their first stores in Russia over the recent five years (this excludes the expansion statistics for chains already present in the market), so on average, some 10 new brands enter the Russian market each year. The overwhelming majority of shopping centres however are little different from each other in terms of tenant mix: owners tend to favor the same popular brands. According to the last published Retail Price Index, the number of retailers in the Russian market is 2.2 times less than in Germany, 1.5 times less than in France and the UK. The Store magazine reports that of the world's 10 largest international retailers, only 2 are currently present in Russia. The other of the big ten, including the industry leader Walmart, take a conservative approach to doing business in Russia: they continue researching the market and selecting strategic partners.

An important trend in the retailer industry is towards higher performance and higher yields on the network. To this end, operators implemented business process optimization, rebranding, relocation and similar programs. E.g. Eldorado, Gloria Jeans and M.Video changed the overall design of their stores, Svyaznoy launched a new business – department store chain Enter – offering a wide range of consumer goods in addition to their traditional product range.

After a burst of activity among international operators who entered the Russian market in 2010, the situation has stabilized back to the trend line



Source: Knight Frank Research, 2012

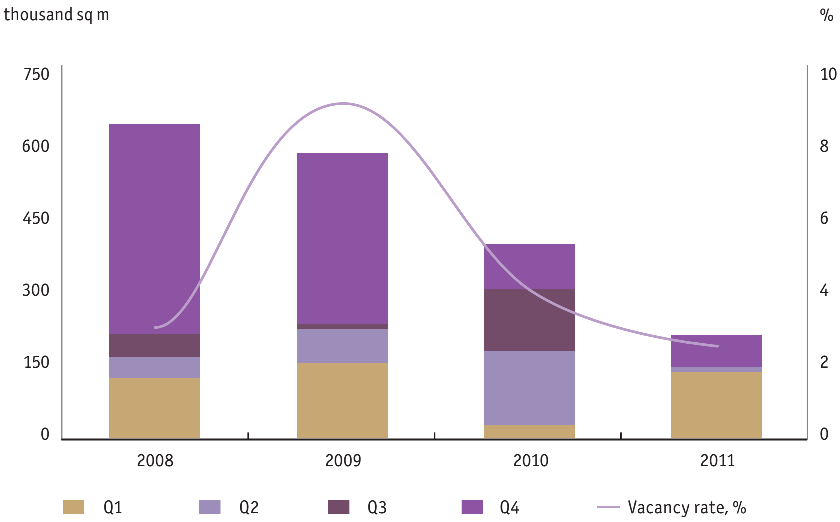
Commercial terms

The operators' pursuit of efficiency, including better store locations, combined with slow supply growth rates, have brought about a strong focus on high-quality, well-located objects. As a result, the most sought-after shopping centres have build up waiting lists of several years, whereas less successful premises were even prepared to reduce their rents to retain tenants. The market average vacancy rate at the year-end dropped to 2.5%.

The short supply and growing demand for retail space from operators have pushed rents up. Rental rates for the most desired premises have risen to 20%, and the market average growth rate was 12-14%. This is partly attributable to tenant rotation policies pursued by some commercial property owners.

The practice of calculating rent as a percentage of sales with a minimum fixed rent component is becoming increasingly common; annual rent adjustment is usually within the range of 5% to 7%. It should also be noted that retailers now take a more responsible approach to the legal aspects of their business. They carefully check land title documents and other permits and make sure that leases contain clauses to protect their interests (e.g. the minimum vacancy rate at the opening date of the shopping centre) as well as withdrawal clauses.

Amid a slowdown in supply growth rate in 2011, vacancy rate kept declining



Source: Knight Frank Research, 2012

Forecast

Seventeen shopping centres are scheduled to open in 2012 in Moscow. If all of them are completed, the new supply may increase to approximately 960,000 sq m which is very close to the 2010 figure and three times the 2011 figure (GLA – 440,000 sq m). In particular, in the year to come it is planned to complete River Mall – the largest ever shopping centre project within the Third Transport Ring.

Rental rates for shopping centres , Moscow, 2011

Type of premises	Area, sq m	Retail profile	Rental rate, $ per sq m per annum*
Anchor tenant area	>5,000	Food hypermarkets	100 - 250
		Others	150 - 300
	1,500-5,000	Food hypermarkets, others	250 - 400
	500-1,500	Food hypermarkets, others	300 - 600
Retail gallery tenants area	300-500	Children's goods	400 - 1,000
		Apparels, footwear (ground and 1st floor)	600 - 1,500
	100-300	Apparels, footwear (ground and 1st floor)	800 - 2,500
	50	Eather accessories, bijouterie, gifts, jewellery, mobile phones (ground floor)	1,800 - 4,500

* Excluding OPEX and VAT (18%)

Source: Knight Frank Research, 2012

The most significant shopping centre projects in Moscow and Moscow Region scheduled for completion in 2012

Name	Address	Total area (sq m)	GLA (sq m)
River Mall	16-18 Avtozavodskaya St	258,000	87,000
GoodZone	12 Kashirskoye Hwy	123,000	77,000
Iyun’	Mytishi, intersection of Volkovskoye Hwy and Mira St	178,000	75,000
Otrada*	2 Pyatnitskoye Hwy	75,000	55,000
RIO	Intersection of Leninski Ave and Obrucheva St	76,000	50,000
Krasny Kit, Phase II	Mytishi, 2 Sharapovsky passage	64,000	49,000
Kaleydoskop	7-23 Khimkinski Blvd	119,000**	41,000
SC at Sheremetevskaya	Intersection of Suschevsky Val St and Sheremetevskaya St	75,000	35,000
Fashion House	Chernaya Gryaz, Leningradskoye Hwy	39,000	29,000
Vnukovo Outlet Village	8 km of Kyevskoye Hwy	47,000	26,000
Parus	1 Novokurkinskoye Hwy	35,500	26,000
Outlet Village Belaya Dacha	Kotelniki, 5 Yanichkin Passage	38,000	25,000
Moskva Gallery	2 Okhotny Ryad St	27,000	22,000
Moskvorech’e	52 Kashirskoye Hwy	30,000	17,000
Park, Phase II	Krasnogorsk, Intersection of Dachnaya St and Pesochnaya St	25,000	17,000
Iyun’ Krasnogorsk	Krasnogorsk, 3 Kommunalny block	25,000	15,000
SC MC	36 Miklukho-Maklaya St	15,700	12,400

* total area and GLA at Otrada shopping centre excluding phase I of the project

** total area of mixed use centre Kaleydoskop, including office area

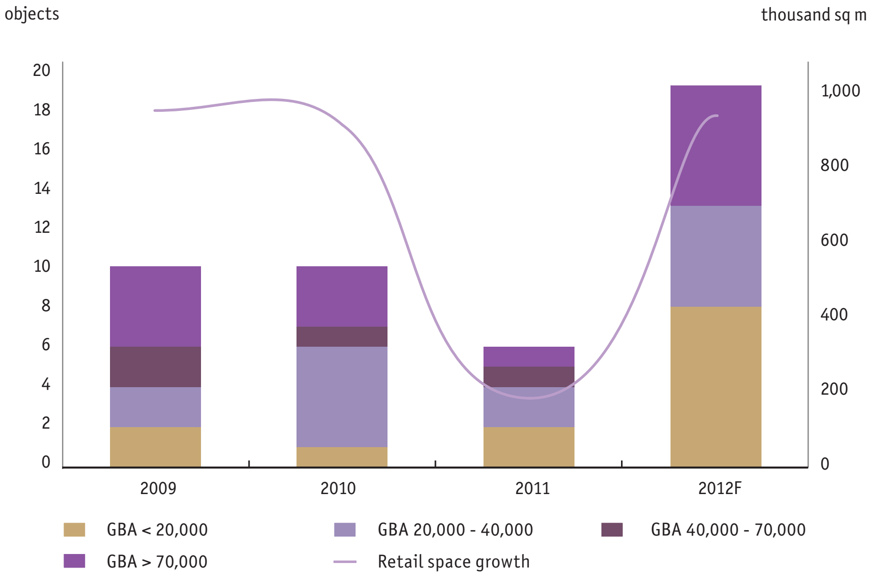
Source: Knight Frank Research, 2012

In addition, in 2012 several large retail projects are scheduled to be opened in the outskirts of Moscow, including outlet centre projects that until recently did not exist in the Russian market*:

- Fashion House – a Fashion House Development project,
- Outlet Village Belaya Dacha – a joint project of Hines and Belaya Dacha,
- Vnukovo Outlet Village – an Diona project.

Such projects are likely to succeed in Russia unless certain conditions are met. The property owner has to develop a sound concept, secure a quality tenant mix, low rental rates and good transportation access.

In 2012, no medium-sized retail projects will enter the market



Source: Knight Frank Research, 2012

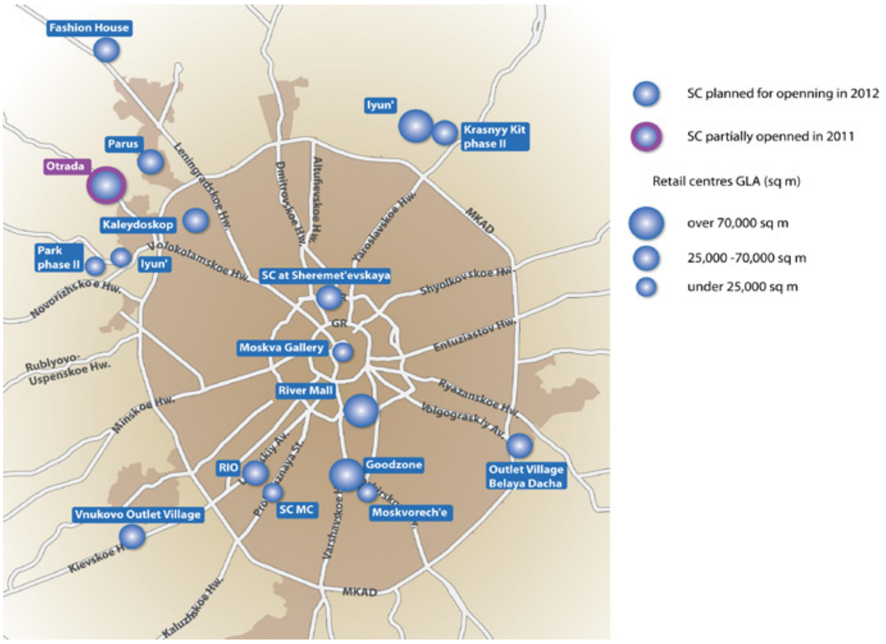
* Internationally, the term “outlet” refers to a shopping centre specialized in selling brand name apparels at large discounts.

Tenants in turn are to keep their prices reasonable and offer a wide range of goods and high service quality.

Due to increased competition, we anticipate improvements in the quality of retail projects in Moscow Region and other regions of the country. Also, in the years to come, full or partial redevelopment of underperforming or obsolete shopping centres will be a rising trend and an essential factor in the competition for tenants and buyers. For instance, the Waymart redevelopment project (Brand City) and Mega Teply Stan renovation project are scheduled for completion in 2012.

In the year to come, the market will continue to decentralize bringing about changes in the concept of shopping centres. In the immediate future new supply will predominantly comprise small shopping centres (with GBA of up to 4,000 sq m) located in densely developed residential communities and catering mainly for those living in the immediate neighborhood. Super-regional centres will be mostly built as part of integrated development projects (e.g.: the All-Russia Exhibition Centre (AREC) renovation project).

The most significant shopping centre projects in Moscow and Moscow Region scheduled for completion in 2012



Source: Knight Frank Research, 2012

Street retail

The Moscow street retail market is expanding at a very slow pace, mainly through new retail area entering the market as part of mixed use centres. Also, 2011 saw an increase in the supply of retail premises with a total area of 60-80 sq m, due to a growing number of residential apartments converted to nonresidential use and redeveloped for retail use.

The last year saw a growing demand for street retail area. This was primarily due to the high activity of national and international retail operators. An additional stimulus was the trend towards scarcity of retail area in shopping centres. Clothing and food store operators continued to pursue aggressive expansion policies. The Russia's fist Wendy's restaurant was opened in Novy Arbat. Also in 2011 flagship stores were opened by Lancel (Bolshaya Dmitrovka St), Miu-Miu, Jimmy Choo and Joseph (Stoleshnikov lane), Tom Ford and Lanvin (Tretyakovsky passage).

A limited supply and growing demand for street retail premises has resulted in a decrease in vacancy rates in the Moscow's central and other largest retail corridors. As of the end of 2011, the market average vacancy rate was in the range of 2% to 10%. As is the case with the most successful shopping centres, the most desirable street retail properties have waiting lists of potential tenants. Rental rates have increased on average by 3% - 5% (in some cases up to 20%).

Rental rates in the main retail corridors of Moscow, 2011

Location	Rate, $ per sq m per annum
The most expensive retail streets within Sadovoye Ring (Stoleshnikov lane, Tverskaya St, Petrovka St, Kamergersky lane)	2,500 – 7,000
Other streets within Sadovoye Ring (Kuznetsky Most St, Pyatnitskaya St, Arbat St, B. Yakimanka St etc.)	1,500 – 3,000
Sadovoye Ring	1,200 – 3,000
Main transportation thoroughfares (Leningradsky Ave, Leninsky Ave, Komsomolsky Ave, Kutuzovsky Ave)	800 – 2,500
Bedroom communities	500 – 1,500

Source: Knight Frank Research, 2012

OVERVIEW

Europe
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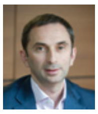

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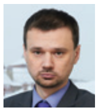

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Established in London more than a century ago, Knight Frank is the renowned leader of the international real estate market. Together with Newmark Company, Knight Frank's strategic partner, the company encompasses 244 offices in 43 countries across six continents.

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