RESEARCH

Knight Frank

2013

RETAIL MARKET REPORT

Moscow

HIGHLIGHTS

- 18 new retail centres opened in 2013, as the second stage of the shopping park Otrada was delivered in Mitino, Moscow. The supply stock thus grew by 600 thousand sq m (GLA – 364 thousand sq m).
- 2013 turned out to be the record year for the retail market of Moscow: 45 international chains opened their first outlets in the capital, 90% of which came to the Russian market for the first time. To date, in total there are 9 of the top 50 global retailers in Moscow.
- Business conditions remained relatively stable throughout 2013. In some of the most attractive shopping centres, the newly signed lease contracts' rates grew by up to 15%. Meanwhile, the vacancy rate in operating shopping centres of Moscow has grown to 3% (2.5% at the end of 2012).

RETAIL MARKET REPORT

Sergey Gipsh,
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"The last year was characterized by the widest expansion of retail operators. Competing with each other, increasing their chains capitalization, they are now ready to adjust its logistics under the proposal of developers, which implement quality projects in various cities of Russia. No longer cities exist beyond which retail operators are not ready to go. They choose among others such remote regions as Irkutsk, Ulan-Ude and Vladivostok for their development".

Key indicators. Shopping centres*

Indicator		Dynamics
Total shopping centre stock (total area/GLA)**, million sq m	7.48 / 4.02	▲
Opened in 2013 (total area/GLA), thousand sq m	600 / 364	
Scheduled to open in 2014 (total area/GLA), thousand sq m	2,035 / 1,015	
Vacancy rate, %	3	▲
Base rents, $/sq m/year (not including operating expenses and VAT)		
anchor tenants	100–500	►
retail gallery tenants***	700–4,000	►
Operating expenses, $/sq m/year	80–260	►
GLA in quality shopping centres per 1,000 population	327	▲

* The table refers only to high quality, professional retail properties. 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, 2014

Main events

- Developers continue to announce new shopping centre projects in the Moscow Region:

  Towards the end of 2015, KVS Group plans to build an SEC Nebo in Solntsevo with the total area of 62 thousand sq m.

  SEC Udachi with the total area of 123 thousand sq m will appear in the Naro-Fominsk district.

  Praktika Development Company announced plans to build an SEC with a total area of about 100 thousand sq m near the future metro station Salar'evo, located on the territory of the New Moscow.

- The Moscow authorities have continued to revise investment contracts:

  A project to build a retail and office centre (total area of 175 thousand sq m) on the 2nd Silikatnaya Street got scrapped.

  An investment contract to build a pedestrian zone Alleya Romanov near Mokhovaya Street was unilaterally terminated.

Supply

The total supply stock of space in the shopping centres of Moscow in 2013 has grown by 600 thousand sq m (GLA of 364 thousand sq m). This result looks impressive against the backdrop of extremely low levels of 2011–2012. Back then, due to the decline in the number of new projects during the post-recession period, the supply growth rate has dropped to a ten-year historic low of the market. However, it is still inferior to the average supply growth rate characteristic of the Moscow market.

In total over 2013, 18 retail centres were opened in Moscow. Furthermore, the second stage of the shopping park Otrada in Mitino became operational. Thus, at the end of the year the volume of supply totaled 7.48 million sq m (GLA of 4.02 million sq m).

It is worth noting that the objects of district and microdistrict formats prevail within the new supply stock: only one shopping centre (Goodzone) delivered in 2013, has a gross leasable area of over 40 thousand sq m. Besides, two objects of GC Tashir (SEC Raikin Plaza and SEC Rio na Leninskom) have a gross leasable area of 35 thousand sq m each. These three shopping centres put together form 40% of the new supply stock.

The development of small-format shopping centres is quite natural considering the lack of stores within the walking distance. It should be stressed that the city authorities also pay attention to this issue. For example, development of small shopping galleries (with the area of up to 4 thousand sq m) in residential areas of the capital was one of the initiatives of the Moscow government.

Two retail properties of outlet format: Fashion House Outlet Centre and Vnukovo Outlet Village opened in 2013. Together with an earlier object of this format, Outlet village Belaya Dacha, which has been operating since August 2012, three outlet centres are present in metropolitan region today, in the northern, western and south-eastern directions respectively.

Largest shopping centres commissioned in 2013

Project	Address	Total area, sq m	GLA, sq m
Goodzone	Bld 12 Kashirskoe Hwy	122,065	65,500
Raikin Plaza	Bld 1, 6 Sheremet'evskaya St	80,000	35,000
Rio Leninsky	109 Leninsky Ave	75,000	35,000
Fashion House Outlet Centre phase 1	Chernaya Gryaz, Leningradskoe Hwy	38,580	28,765
Sportex	2 5th Kabelnaya St	32,000	22,000
Vnukovo Outlet Village phase 1	Kievskoe Hwy, 8 km from MKAD	29,736	16,584
Konfetti	16 Nagatinskaya St	25,000	17,600
VDNH	55 1st Ostankinskaya St	23,000	19,500
Mandarin	9 Montazhnaya St	20,568	17,700
Picnik	Novoivanovskoye, bld 4 Zapadnaya St	20,000	17,000

Source: Knight Frank Research, 2014

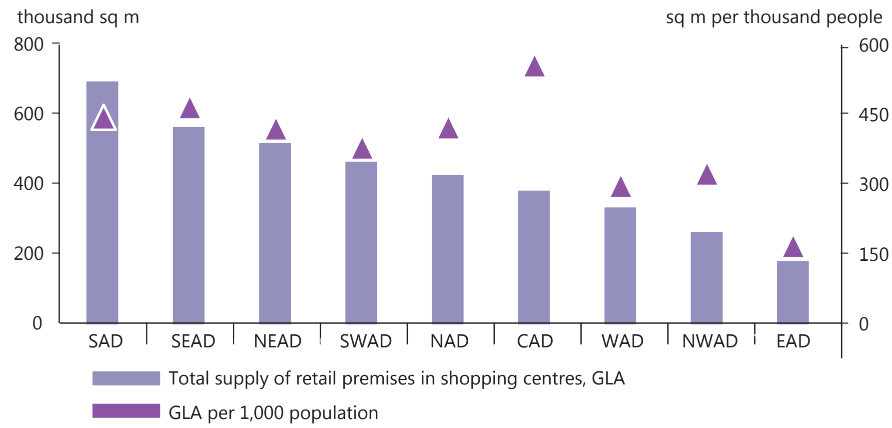
The segment of specialized retail properties continues to develop. A new sports and entertainment centre Sportex has joined its ranks last year, also two furniture complexes have been commissioned last year: Mandarin and Roomer.

The new shopping centres are mainly concentrated in the south of the capital. Thus, the SAD (the most populous district of Moscow) has strengthened its leading position in terms of the supply stock volume, thus joining the top three districts with the highest amount of high-quality retail space per 1,000 inhabitants. Due to low population, CAO still holds leadership according to this indicator. As to the East of the capital, where the retail real estate market is the least developed, no significant changes have occurred: delivery of one district-format shopping complex did not improve the situation.

Retail space growth in 2004–2014

Source: Knight Frank Research, 2014

Total supply of shopping centres by districts. Retail space per 1,000 residents



Source: Knight Frank Research, 2014

Development of previously suspended shopping centre projects is being resumed all the more often. Typically, this process is preceded by a change of ownership of the property. For example, in Q3 2013, the Korona-Market Company received permission to build an SEC Abramtsevo simultaneously putting the project up for sale (the potential buyer is Renaissance Development Company). Furthermore, in the near future one can expect the development of SEC River Mall to be resumed due to its purchase by the Praktika Development Company.

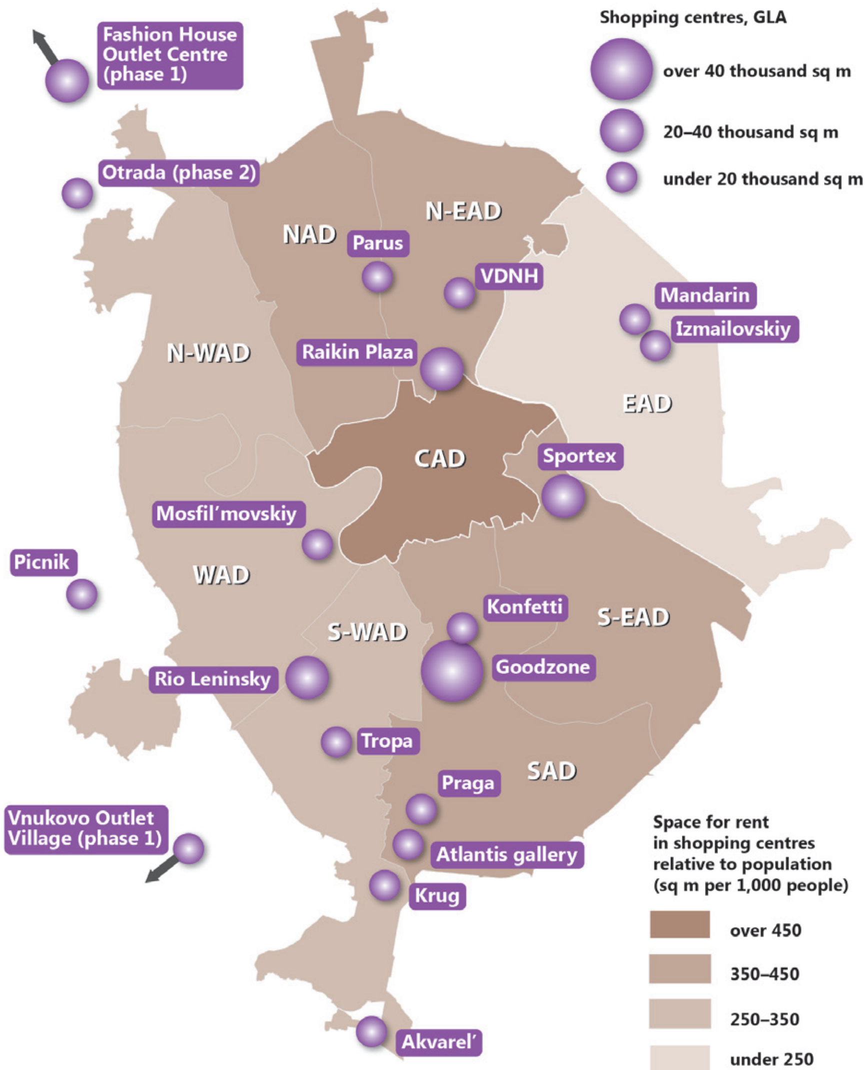
Demand

While the growth rate of retail turnover in Russia is slowing down, in Moscow, to the contrary, it is growing: 3.6% in 2013, compared with 1.5% the previous year. This is partly determined by the metropolitan citizens' mentality: the rise in prices (according to Rosstat, the inflation in Moscow amounted to 6.2% in 2013) has almost no effect on their spending habits. Moreover, the current economic situation (a drop of confidence in banks, high volatility of the ruble) stimulates current expenditure growth with the population. For instance, while in 2010 the Muscovites have spent 70.7% of their revenues on goods purchasing, in 2013 this figure reached 79.7%. It is interesting to note that for the same period, the excess of expenditure over the citizens' earnings has doubled going from 8.5% in 2010 to 15% in 2013. This means that the share of goods purchased on credit has grown.

Indeed, over the 2013, the volume of loans given to the population of Moscow has grown by 20%, so the total debt of citizens to the banks at the end of the year exceeded 100 thousand rubles per person based on the number of residents.

Household appliances and electronics are leading among the goods purchased on credit: more than 20% of all purchases in the segment are made in this way. Retailers encourage public spending by introducing new credit programs. For example, the industry leader M.Video has announced plans to expand cooperation with the bank Setelem, a subsidiary of Sberbank. While Media Markt, in turn, offers professional broker services to its clients. Opticians, jewelry stores, department stores and others offer their customers an opportunity to purchase the desired item on credit. Online credit services are also rapidly expanding. In order to obtain a loan to purchase a product from an online store, the buyer needs to fill out an online application form and attach a copy of their passport. However, considering the growing proliferation of credit cards that allow one to purchase products in any shop and have a grace period of debt repayment, the growth of express-crediting segment is likely to slow down.

Shopping centres opened in 2013. Retail space per 1,000 people



Source: Knight Frank Research, 2014

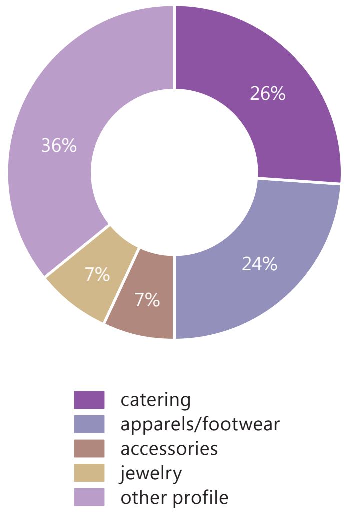
High growth of internet sales stimulates the retailers to intensify their online presence by expanding the websites' functionality and increasing activity on social networks, etc. Zara, Karen Miller and others began to operate online stores in Russia in 2013.

Combination of different sales channels is an effective tool. For example, in order to attract online shoppers to one of their stores, some operators offer discounts on goods when they are ordered online. On the one hand, this approach allows the company to avoid additional shipment costs, on the other – to "lure" customers into the store, where they could make other purchases. One should be reminded that the share of impulse purchases of various accessories in home appliance stores reaches up to 30%, and up to 50% for supermarkets.

Constant expansion of the range of goods at major chains is one of the retail market trends in recent years. Consequently, the stores' space also grows: instead of the previously common 150–200 sq m, many clothing brands are now considering premises with an area of 300 sq m or larger. Some companies provide separate product groups, releasing them on the market under a new brand. For example, following the largest Spanish retailer Inditex, in 2013, H&M introduced a line of home products H&M Home in the SEC Afimall, while the first accessories store GUESS Accessories of the eponymous brand was opened in the SEC Golden Babylon Rostokino.

Another trend in 2013 was the popularization of a "shop+" format (a combination of different retail concepts or functions

Catering chains dominate among the new international operators



Source: Knight Frank Research, 2014

within a single space). For example, in the early 2013, Nike has opened its first store with a dedicated area for exercising following the Nike Training Club system in the SEC Metropolis.

The past year turned out to be the record year for the retail market of Moscow: 45 international chains opened their first outlets in the capital, 90% of which came to the Russian market for the first time.

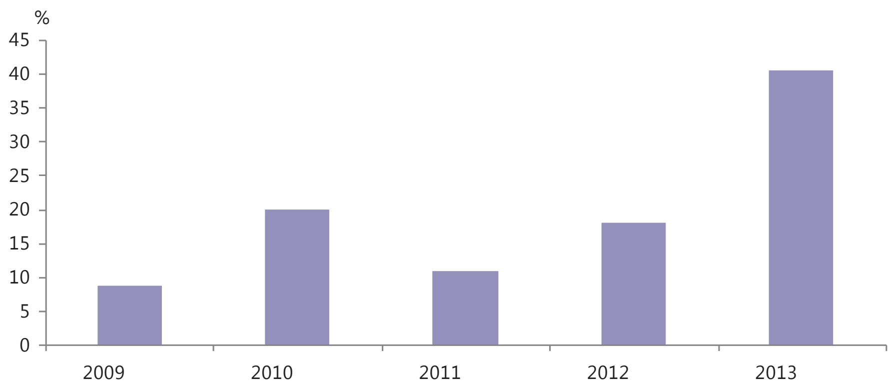
Catering segment went through the most active development: numerous restaurants of Japanese, Asian and Italian cuisines opened that year. However, the U.S. has become the leader in terms of the number of chains: such famous brands as Nathon's, Johnny Rockets, Krispy Kreme, Quiznos, etc. are now presented in Moscow.

According to Stores.org, in total, 9 of the world's top 50 retailers operate in Moscow to date. Moreover, in the apparels segment the top 5 operate in the Russian capital except for the American TJX Companies (such brands as T.K. Maxx, HomeSense and others).

As to the platforms picked by the new players to start on the market, a lot depends on the profile of the tenant, price segment and its target audience. For instance, conceptual clothing brands prefer the Tsvetnoy department store: a shop of British brand Casely-Hayford opened there last year. The clothing brands of mass-market segment choose malls with the highest consumer traffic: Evropeisky, Metropolis, and Afimall. The brands of higher price market segment usually open flagship stores in street-retail; among the shopping centres, they choose Crocus City Mall and Vremena goda.

Among the anchor tenants, grocery chains demonstrate rapid development rate. New hypermarkets, Auchan and Globus, opened in 2013. In December, the second hypermarket O'key was opened in the SEC Goodzone within MKAD (the first one is located in the SEC Zolotoy Vavilon Rostokino). Moreover, the grocery chain Lenta from St. Petersburg has come to the metropolitan market. It has opened 10 supermarkets and aims to get a solid foothold in the Moscow Region: in 2014, it will open another hypermarket in the SEC Mozaika.

40% of all international operators that came to the Moscow market for the last 5 years opened their first store in 2013



Source: Knight Frank Research, 2014

Commercial terms

A gradual reduction of the base lease with a growing share charged to the tenant turnover is among the latest lease terms trends for retail facilities in the shopping centres of Moscow. Over the past five years, the share of contracts with a combined lease rate has grown 2.5 times, reaching 70%. Many major fashion-operators and distributors (e.g. GC JamilCo, Jeans Symphony) sign their lease contracts according to the aforementioned scheme all the more often. Such trend is popular because this way both the developer and the tenant are

Rental rates in modern shopping centres in Moscow, 2013

Profile	Fixed rental rate*, $/sq m/year	The share paid based on turn-over, %
Hypermarket (>7,000 sq m)	100–250	2–4
Urban hypermarket (3,000–7,000 sq m)	150–350	2–4
Supermarket (1,500–3,000 sq m)	250–500	4–6
DIY (>5,000 sq m)	200–350	4–6
Home appliances (1,500–3,000 sq m)	250–500	4–5
Sporting goods (1,500–2,500 sq m)	400–1,200	4–5
Goods for children (1,000–2,500 sq m)	250–450	9–12
Apparels (50–300 sq m)	800–2,500	12–16
Footwear (50–300 sq m)	900–3 000	12–16
Accessories (10–70 sq m)	2,500–4,500	11–14
Movie theatres	150–250	3–5
Entertainment centres (100–1,500 sq m)	250–500	8–12
Entertainment centres (2,000–5,000 sq m)	100–200	4–7

* Excluding operating expenses and VAT (18%)
Source: Knight Frank Research, 2014

equally interested in the success of the shopping centre.

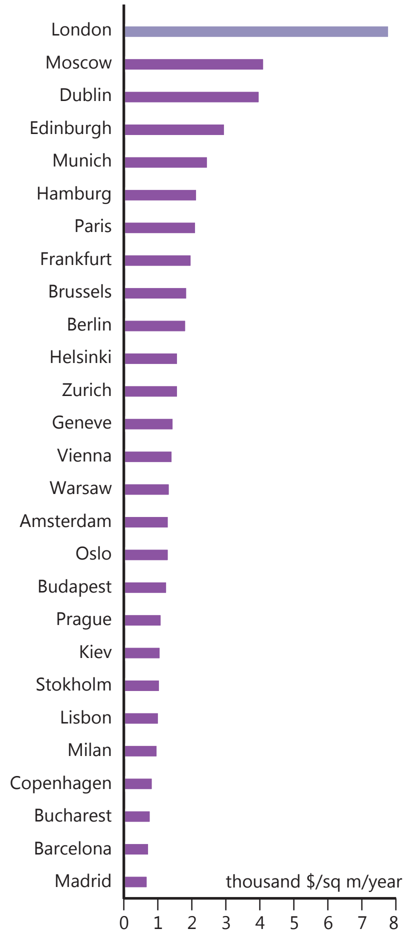
During 2013, commercial terms remained relatively stable. The owners of some of the most sought-after objects have adjusted the rates at the signing of new leases, increasing them by up to 15%. Meanwhile, the vacancy rate in operating shopping centres of Moscow has grown to 3% (2.5% at the end of 2012).

It should be noted that vacant spaces are non-existent in the shopping centres of the highest quality: such facilities have lists of tenants willing to open their stores, according to our estimates, more than 10% of Moscow shopping centres have significant waiting lists.

On opening, a shopping centre is usually filled with tenants at only 40–50% capacity. This is because the retailers seek to optimize their costs and make sure that the mall will be successful before leasing space there. Thus, a shopping centre starts working normally a year after its opening, reaching the maximum level of efficiency after 3 years.

Forecast

Rental rates in the most successful European shopping centres



Source: Knight Frank Research, 2014

Main commercial terms and performance indicators of shopping centres of regional format, 2013 (% of the maximum)

Indicator	Period after the shopping centre opening					
	3 months	6 months	1 year	3 years	3–7 years	More then 7 years
Base rental rate*	50–70%	70–100%	100%	100%	100%	100%
The share paid based on turnover	100%	100%	100%	100%	100%	100%
OPEX	100%	100%	100%	100%	100%	100%
Attendance	50–60%	60–70%	95–100%	100%	100%	100%
Vacancy rate**	15–17%	10–15%	7–10%	1.5–3%	3–4%	5–6%

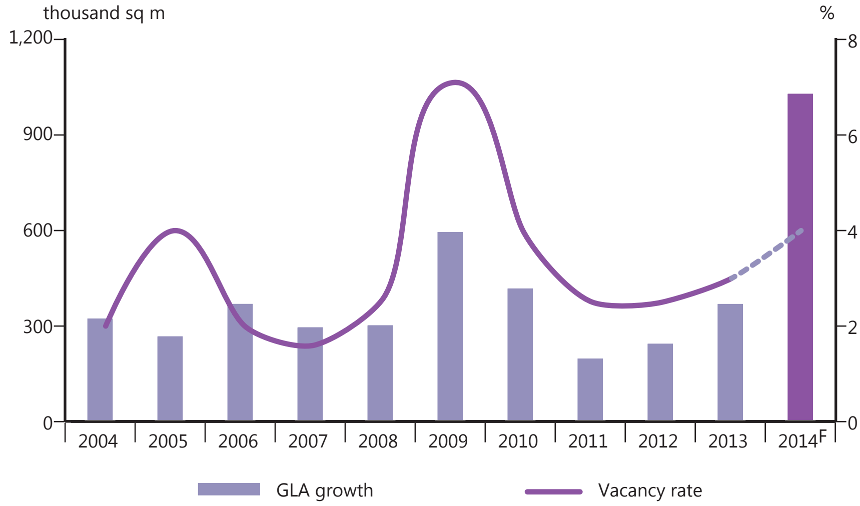
* Rental rate is discounted till the leasing of 70-80% of the shopping centre leasable area
** % of area not leased to the operators
Source: Knight Frank Research, 2014

Largest shopping centres scheduled for opening in 2014

Project	Address	Area, sq m Total	Area, sq m GLA
Avia Park	38a Khoroshevskoe Hwy	300,000	231,000
Vegas Crocus City	66 km MKAD	295,000	105,000
Columbus	Bld 140 Varshavskoe Hwy	277,000	140,000
Kuntsevo-plaza	19 Yartsevskaya St	212,000	64,000
Butovo Mall	Intersection of Ostaf'evskaya St and Checherskiy passage	143,000	65,000
Mozaika	Bld 3a Kozhukhovskaya St	134,000	68,000
Vesna!	Intersection of Altuf'evskoe Hwy and MKAD	126,000	56,000
SC on Ryazanskiy Ave	Bld 20 Ryazanskiy Ave	95,700	30,000
Reutov Park	Reutov, Nosovikhinskoe Hwy, 2.5 km from MKAD	90,000	41,000
Vodny	Bld 5 Golovinskoe Hwy	48,500	32,500
Yasenevo	Bld 7 Novoyasenevskiy Ave	40,000	17,000
Evolution Tower	MIBC Moscow-City, plots 2–3	36,000	21,000
SC on Porechnaya St	10 Porechnaya St	35,000	н/д
Hanoi-Moscow	Intersection of Yaroslavskoe Hwy and MKAD	31,500	н/д

Source: Knight Frank Research, 2014

In 2014, record growth of shopping centres supply is expected



Source: Knight Frank Research, 2014

23 shopping centres with a total area of 2.04 million sq m (GLA of 1.02 million sq m) have been announced for delivery in 2014 in the Moscow region. While more than 30 objects are at the design stage.

Considering the current situation on the Moscow retail real estate market with its growing competition, we also expect growth of the number of objects whose owners might be thinking over the need for redevelopment of one degree or another. This applies to both: the Soviet heritage objects (department stores, trade houses), and the shopping centres built at a very early stage of retail property market development in the capital. One can already witness the redevelopment of some of them. For example, a shopping centre chain Mega is modernizing its first malls, while ENKA is implementing a comprehensive renovation of the territory, upon which the very first professional shopping centre, the Ramstore, was located.

We expect that the high rate of market penetration by the international operators in Moscow will persist in 2014; the opening of largest retail complexes should further reinforce this effect. Many major chains choose precisely such facilities to represent their brand on a new market.

Simultaneous opening for lease of several landmark shopping centres gives operators ample room for development: they now have the choice of premises that are best suited to their interests.

At the same time, such a significant growth of supply will lead to an increase of vacancy rate, which might reach 7% by 2015.

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