RESEARCH

Knight Frank

H1 2014

RETAIL MARKET REPORT

Moscow

HIGHLIGHTS

- The total area of high-quality retail space in Moscow shopping centres for H1 2014 has grown by 556 thousand sq m (GLA – 231 thousand sq m), reaching 7.93 million sq m (GLA – 4.16 million sq m) by the end of Q2.
- For the reported period, 14 new international brands appeared in the capital, with more than half of them belonging to "clothing and footwear" segment.
- On average, lease rates on the market remain unchanged. Growth of base lease rates persists in the best shopping centres, whereas developers of less successful projects make concessions when negotiating contracts with tenants.
- In the case all of the previously announced shopping centres will be delivered, overall supply for the year could grow by more than 1.3 million sq m (GLA – 0.7 million sq m).

RETAIL MARKET REPORT

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"Against the background of rapidly growing shopping centres supply, the position of tenants now having the option of choice has significantly strengthened. They prefer to open stores in the best Moscow facilities, whereas owners of the rest of the projects have to make compromises: to provide discounts and negotiate various additional terms. Developers, who think strategically, understand that these are temporary measures and such a strategy in the future will bear fruit in the form of high-quality tenant pool, opening of shopping centres with high occupancy rates, etc".

Key indicators. Shopping centres*

Indicator		Dynamics
Shopping centres stock (total area/GLA**), million sq m	7.93/4.16	▲
Commissioned in H1 2014 (total area/GLA), thousand sq m	556/231	
Scheduled for commissioning in H2 2014 (total area/GLA), thousand sq m	1,352/708	
Vacancy rate, %	3.5	▲
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 residents	343	▲

* 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

Supply

In Q2 2014, two major shopping centres have opened in MKAD: Vegas Crocus City and Vesna!. Furthermore, a shopping centre MZ has opened by the Belyaevo subway station. As a result, the total area of high-quality shopping centres of the capital for the period grew by 437 thousand sq m (GLA – 173 thousand sq m), reaching 7.93 million sq m (GLA – 4.16 million sq m) by the end of the quarter. We would like to remind that SECs Reutov Park and Moskvorech'e opened in Q1. Thus, the total growth of supply stock in H1 2014 (GBA – 556 thousand sq m, GLA – 231 thousand sq m) exceeded annual results of the previous years (2011–2012), almost reaching the volumes of last year.

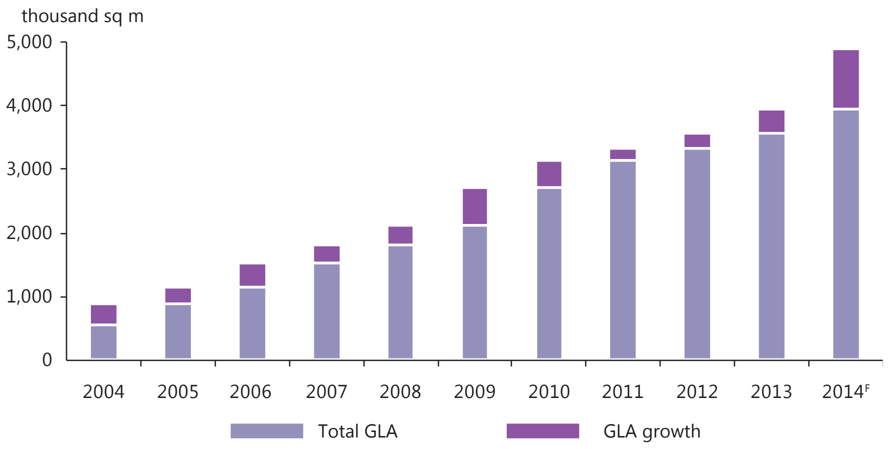
New shopping centre projects were announced in H1 2014. Among them, the

Largest shopping centres commissioned in H1 2014

Object	Address	Total area (GBA), sq m	GLA, sq m	Developer
Q1				
Reutov Park	45 Nosovikhinskoe Hwy, Reutov	90,000	41,000	Amma Development
Moskvorech'e	52 Kashirskoe Hwy	29,750	16,650	Garant Invest
Q2				
Vegas Crocus City	66 km, MKAD	295,000	105,000	Crocus Group
Vesna!	intersection of MKAD and Altuf'evskoe Hwy	126,000	56,000	Central Properties и Alto Assets
MZ	36 Miklukho-Maklaya St	15,700	12,400	SYUZ

Source: Knight Frank Research, 2014

Moscow shopping centres supply dynamic, 2004–2014



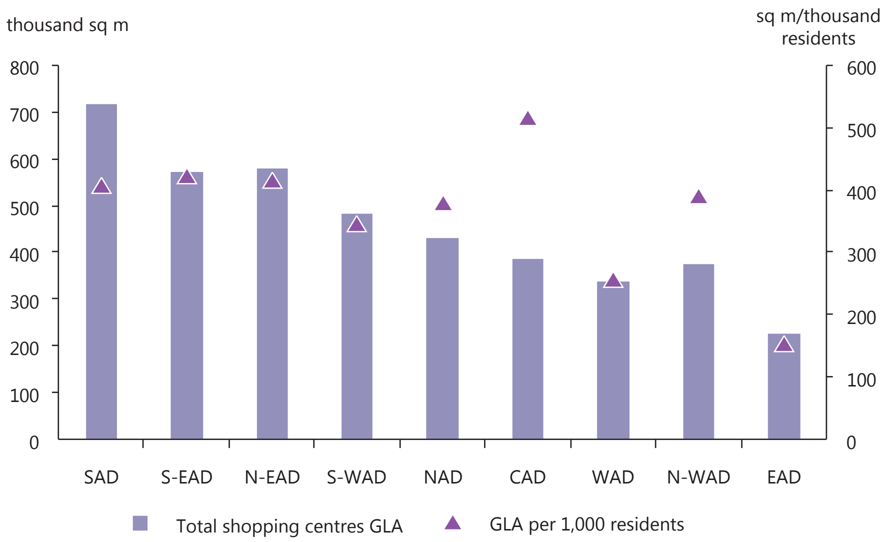
Source: Knight Frank Research, 2014

SEC at Preobrazhenskaya Ploshad' in Moscow, SEC in Mytishchi, developed by the GC Tashir and others. The interest of developers, including international ones, to suburban towns of Moscow grows every year: more than 50 projects at different stages of development are present in the Moscow Region and New Moscow territories. In addition to traditional shopping centres, opening of several retail parks, located along the main roads of the region, is expected in the near future, for example, Torgovy Park № 1.

This format has barely seen any development in the Moscow Region until now: the companies were mainly focused on development of classical shopping centres, providing maximum profitability. However, positive experience of spontaneous retail parks in conjunction with a number of advantages of such format (lower construction costs, implementation in stages, fast ROI and ease of management) contributed to its active development in the past two years.

Moreover, the emergence in the region of several wholesale and exhibition centres cannot be overlooked: the Torzhok at the intersection of the Moscow Ring Road and the Leningradskiy highway, the Foodcity three kilometers away from MKAD in the direction of Kaluga, Expolon at the Kosinskaya street. Despite the fact that the aforementioned complexes differ in price segment and target audience, they are based on a common concept of presenting manufacturers' products on a single platform. Whether it shall prove successful remains to be seen.

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



Source: Knight Frank Research, 2014

The variety of retail formats is a testament to the gradual transition of the market to a more mature state. This process is traditionally accompanied by a growth of competition: consequently, the question of redevelopment becomes even more pressing for the owners of facilities built several years ago.

Even popular shopping centres are forced to adapt to changing market demands in order to maintain a stable level of attendance. The IKEA Company is exemplary in this regard: it regularly conducts such activities in the shopping centres, as renovation of entry zones or reconceptualization of food courts, etc.

Moreover, whereas for some complexes a little intervention is sufficient to remain competitive, in the case of others, demolition of the old facility and construction of a new one might be the best option. For example, at the moment, the construction of the mixed-use complex with a retail component Kuntsevo-Plaza is in its final stages on the site of the first professional shopping centre of Moscow near the subway station Molodezhnaya.

Large shopping centres opened in H1 2014 are located outside MKAD, whereas objects of district format – inside the city. Thus, the situation with provision of Muscovites with retail space in the context of metropolitan districts remained virtually unchanged. The Eastern Administrative District lags behind the most in this regard. In the short run, this lack of high-quality shopping centres in the EAD will remain; notwithstanding several major projects, none is currently under construction.

Demand

A survey conducted by Rosstat in Q2 2014 demonstrated growth of consumer confidence index with Russian citizens, although the score is still in the negative zone. At the same time, the pace of trade turnover growth is slowing down: for example, for the period from January to May 2014, the average figure for Russia was 3.1% against 3.9% a year earlier. It is also an interesting fact that in Moscow the growth of trade turnover during the period remained unchanged (3.1%).

In general, H1 2014 is not characterized by high consumer activity: according to the Watcom Company, attendance of Moscow shopping centres has dropped by 7–10% compared to the same period last year. Many special promotion campaigns and inter-seasonal sales carried out by the operators also serve an indirect confirmation of this fact. It should be noted that these marketing tools are traditionally the most popular with trade companies as means of stimulating demand. Meanwhile, the market realities have changed: to win the trust and loyalty of a modern consumer, trade chains need to provide a new level of service. An individual approach to each client is required. As multiple studies show, buyers will most likely return to the store where they were warmly greeted and felt sincere desire to help from the sellers, even if they could not find a suitable product to buy. This approach will not only increase the overall conversion percentage, but also will promote constant expansion of consumer audience.

According to Rosstat, sporting goods, perfumery and cosmetics, as well as household products developed the most actively in the segment of non-food retail trade in the first months of 2014.

Food chains also retained stable growth rates, with low-price (discounters) and high-price operators as leaders. For example, Azbuka Vkusa has started development of two new formats: convenience stores AB Daily and grocery hypermarkets AB market.

Concerning the new brands, 14 international brands appeared in the capital in H1 2014. Furthermore, in contrast to last year, where catering segment prevailed, more than a half of brands that came to the Moscow market during the considered period belong to the “clothing and footwear" segment.

In total, nine of the world's top 50 retailers operate in Moscow to date according to the Stores.org portal. Moreover, for the “clothing/shoes” segment, top-5 companies are present on the market of the Russian capital except for the American TJX Companies (such brands as TK Maxx, HomeSense and others).

The retailers are all the more willing to incorporate online sales practices. In March 2014, the plans of IKEA Company to open an online store in Russia became known, with a pilot version of the project already launched in Omsk. In total, as projected by the centre for strategic research Enter, e-commerce turnover in Russia in 2014 may grow by almost 30% thus repeating the result of last year.

Commercial terms

Following the drop in attendance and, as a consequence, smaller turnover, retailers revised their development plans. Many chains continued expansion, although not as actively as initially planned: they consider only the best shopping centres of the capital with the highest traffic as lease options, the sites under construction are often less attractive for them. Because of this tenant policy, some developers

Main commercial terms and performance indicators of shopping centres of regional format

Indicator, (% of the maximum)	Period after the shopping centre opening					
	3 months	6 months	1 year	3 years	3–7 years	More than 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

Rental rates in modern shopping centres in Moscow, H1 2014

Profile Fixed rental rate*,	$/sq m/year	The share paid
Hypermarket (>7,000 sq m)	100–280	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	2.5–5%
Sporting goods (1,500–2,500 sq m)	250–450	5–8%
Goods for children (1,000–2,500 sq m)	250–450	9–12%
Apparels (50–300 sq m)	800–2,500	11–16%
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	7–11%
Entertainment centres (100–1,500 sq m)	220–500	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

are faced with certain difficulties in the brokerage of new facilities.

For example, technically, at the time of opening of SEC Goodzone in December 2013, only the hypermarket O'key was operating in the centre. At the same time, shopping centres Vesna! and Moskvorech'e were more than 65% full upon opening.

It should be noted that a new shopping centre usually starts operating at its normal capacity a year after since its opening, reaching the maximum efficiency towards three years of operation.

The average vacancy rate in shopping centres of the capital operating for more than a year, at the end of H1 2014 was 3.5%. Facilities of the highest quality are still in high demand with potential tenants; in such complexes, vacant premises are absent.

On average, market rates remain unchanged, although in the process of lease negotiation developers in some cases provide prospective tenants with discounts (for example, offering the so-called "step-rent" – a discount on the base lease rate for the first years of operation with its consequent gradual growth), establish the minimum occupancy percentage for the facility, extend the time of lease-free holiday periods, etc.

Largest shopping centres scheduled for opening in H2 2014

Object	Address	Total area (GBA), sq m	GLA, sq m
Avia Park	38A Khoroshevskoe Hwy	300,000	231,000
Columbus	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	3A Kozukhovskaya 7th St	134,000	68,000
SEC on Ryazanskiy Ave	20 Ryazanskiy Ave	95,700	30,000
Vodny	5 Golovinskoye Hwy	48,500	32,500
Yasenevo	7 Novoyasenevskiy Ave	40,000	17,000

Source: Knight Frank Research, 2014

Forecast

A significant number of shopping centres, including several landmark projects, were announced for opening by the end of the year in Moscow. The total supply stock may grow by more than 1.3 million sq m (GLA of 0.7 million sq m). Against the backdrop of active projects' construction, the vacancy rates in shopping centres of Moscow could grow up to 5% in the near future.

We expect the role of the shopping complex management companies to grow as new projects enter the market. For a highly competitive market, the success of the project largely depends on how it is managed. Market offers examples of situations where a change of managing company resulted in rapid image deterioration of previously popular shopping centres. Moreover, there are opposite examples of when the actions of a competent managing company (finding the right tenants, marketing campaigns, etc.) gave a new life to what seemed like an unsuccessful facility.

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