OVERVIEW

H1 2011
INVESTMENT MARKET
Moscow
Knight Frank

EXECUTIVE SUMMARY

- The number of financing transactions on the commercial real estate market more than doubled in the first half of 2011 compared with the same period of last year (y-o-y).
- Investments in commercial real estate in H1 2011 doubled y-o-y and were only 20% below their level in FY 2010.
- Foreign investors switched from passive monitoring of the market to active involvement in 2011, carrying out a number of transactions. Several more transactions are at advanced stages of negotiation.

INVESTMENT MARKET

Main indicators for the Russian commercial real estate market in H1 2011

Segment	Office		Retail	Warehouse		Hotels[1] 3-5★
Class	A	B		A	B	
New supply, sq m;	124.7	204.3	260.0	28.5	37.3	770
change from start of year, %	+6.0%	+2.2%	+3.3%	+0.7%	+2.0%	+2.4%
Vacancy rate, %;	14.5%	19.2%	2.0%	2.0%	4.0%	60.0%
change from start of year, p.p.	-2.4 п.п.	-1.3 п.п.	-2.0 п.п.	-3.0 п.п.	-3.0 п.п.	+1.3 п.п.
Rates, $ per sq m per annum;	815	470	100-400 / 600–4,000[2]	125–135	95–110	164
change from start of year, %	+7.2%	+3.3%	+9.0%	+11.0%	+9.0%	+9.0%
Yield[3] , %;	8.5–9.0%	10.0–11.0%	9.0–10.0%	11.0–12.0%		-
change from start of year, p.p.	-1.5 п.п.	-1.0 п.п.	-1.5 п.п.	-0.5 п.п.		-
Average sale price; $ per sq m	6,000–8,000	4,000–6,000	2,000–4,000	1,000–1,300	600–800	200-1,000

[1]For hotels the respective lines show: number of new rooms; room occupancy (%); average daily rate ($ per room per day); and average selling price per room (thousand $ per room)
[2]Figures for anchor tenants and retail gallery operators
[3]Estimated cap rate
Source: Knight Frank Research, 2011

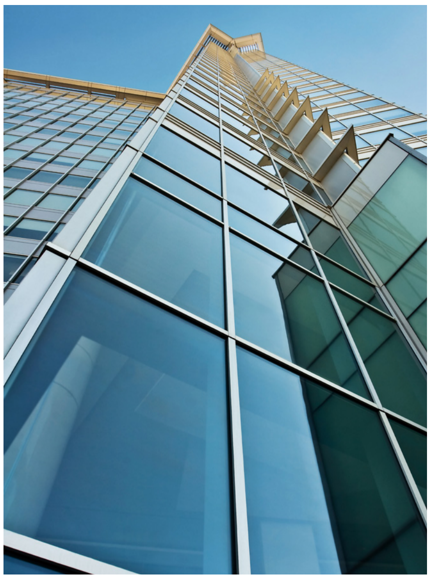
Evgeny Semenov
Director of Investments and Sales

Investments in commercial real estate saw major improvement in the first half of 2011. Development projects have come to life and foreign investors are returning to the market. We expect foreign investors to account for about 30% of the value of all deals in full-year 2011.

We estimate that commercial real estate investments were about $4.4 billion last year and we expect a higher figure in 2011. There is also strong likelihood of greater investor interest in regional projects due to shortage of high-quality investment properties in Moscow.

The recent period has been marked by distribution of investments between various commercial real estate segments. Retail led in the first half of 2011 both by overall value of completed transactions and by their number: share of retail in overall value of commercial real estate transactions was above 40% in H1 2011, pushing the traditional leader – office property – into second place.

Preference of investors for retail was determined by high availability of shopping centres in both Moscow and the regions, often at attractive prices, while there was a shortage of investment-quality properties in the office segment. Greater flexibility in managing yield of shopping centres compared with office centres is also an important factor.



Main financing / refinancing transactions for real estate projects in H1 2011

Lender	Borrower	Purpose	Transaction details
Sberbank	ALCON Group	Construction of the ALCON business complex on Leningradsky avenue (Moscow)	Credit line up to $110 mln for 7 years
	Renova	Various regional projects	5 bln rubles
	RGI International Limited	Construction of the Tsvetnoy Central Market shopping mall in Moscow (36,500 sq m total space)	$150 mln
	Mirax Group	Repayment of a loan from Alfa Bank, completion of the Federation complex in Moscow City	$370 mln
	Dekmos	Completion of construction work at the Moskva Hotel	10 bln rubles
VTB	Hals-Development (former Sistema-Hals)	Project financing and debt refinancing for Sistema-Hals	Increase of credit line by 35% to 23.5 bln rubles.
Tatarstan branch of VTB	Tatstroy	Construction of facilities for the 2013 Student Games	Credit line of 500 mln rubles for 2 years
Gazprombank	MirLand Development	Construction of the Vernisazh shopping mall in Yaroslavl	$29.1 mln
Srednerussky Bank	MLP Podolsk	Construction of the second phase of the MLP Podolsk class-A warehouse complex,	$143.8 mln
Khanty-Mansi Bank	Surgutgazstroy	Final stage of construction of Surgut City Mall in Khanty-Mansi Autonomous District, with total space of 154,000 sq m	3 bln rubles
Raiffeisenbank	Mabruk	Completion of the Miller Centre shopping mall in Saint Petersburg	$27 mln loan for 9 years
	Raven Russia	Construction of class-A warehouse projects in the towns of Klimovsk and Lobnya	$68 mln
Komercni banka (Czech Republic)	Clover Group	Construction of the mixed-use complex Clover Plaza (100,000 sq m total space)	€30 mln

Source: Knight Frank Research (based on open sources), 2011

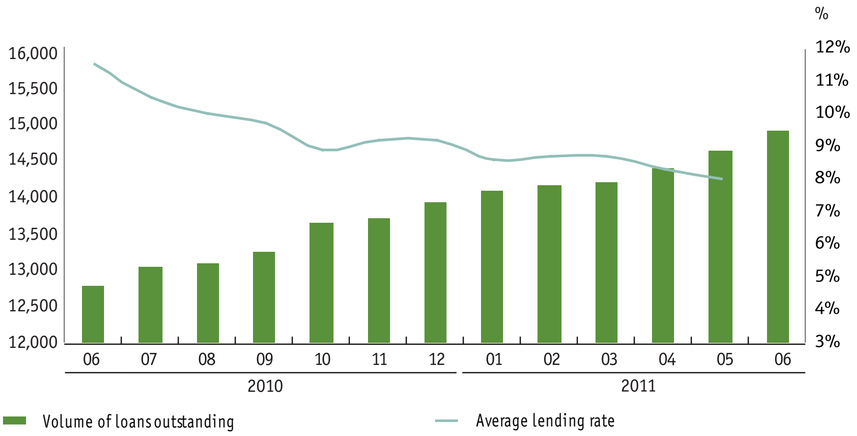
Financing

Lending picked up throughout the real sector in H1 2011 and the real estate market was no exception. The number of new bank loans for development projects more than doubled y-o-y, helped by generally favourable market conditions: excess liquidity enabled banks to increase their corporate lending and gradual reduction of loan interest rates to average 8% by May encouraged demand for credit. The volume of loans outstanding had increased by 17% at the end of June 2011 compared with a year earlier.

There is a more mixed picture as regards supply of credit to the construction sector. Banks continue to provide credit on quite favourable terms to their established partners. But newcomers find it almost impossible to obtain bank financing on similar terms.

The average lending rate to non-financial organisations fell by 3.5 p.p. in 12 months, while volume of loans outstanding rose by 17%

bln roubles, %



Source: Knight Frank Research based on Russian Central Bank data, 2011

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Moscow

Banks have learnt their lesson from the crisis period, and are now giving careful consideration to collateral quality, so that liquidity of a project has become a key criterion for obtaining loan financing. This means that projects close to completion, with central location and a good pool of tenants usually have no trouble sourcing financing. Banks are in competition to finance projects, which meet these criteria, due to their short supply (now as previously).

Large Russian banks remain the chief source of financing for development projects. Banks with foreign capital are gradually returning to the Russian real estate market, but their involvement in new lending transactions was very limited in the first half of 2011. Foreign institutions have carried out a few refinancing transactions, but are mainly holding back from lending to Russian developers.

The large number of consolidated real estate assets has led to a paradoxical situation where banks themselves have become active players on the real estate market.

Supply / demand

Improvement of commercial real estate investment levels, already visible in 2010, became pronounced by the middle of this year with a y-o-y increase of 2.5 times in H1 2011. The growth was driven by excess liquidity on the market in combination with deferred demand after the depression of recent years.

Activity by foreign investors was sluggish in the last two years and their involvement in transactions was fragmentary. The end of 2010 and start of 2011 saw foreign players change their tactics from passive monitoring to action. More than 10% of transactions in the first half of 2011 involved foreign capital, and they included purchase in May by Hines Global REIT of a 75,000 sq m warehouse complex in Khimki.

Undoubtedly, the main driver for investments is cheaper financing, and a number of specific market trends deserve to be noted:

- Deferred demand, accrued during the post-crisis period, explains a large part of the increase in transaction volumes.
- There is a steady trend towards larger transaction size. Half of completed transactions last year were worth less than $100 million, while the first six months of 2011 have seen a number of deals with value in excess of $500 million.
- The shortage of investment-quality projects has encouraged interest in less attractive assets. There has also been an upsurge of investments in developer projects.
- Moscow city hall policies of reviewing existing investment projects and prohibiting commercial real estate projects inside the Third Transport Ring has made most developers adopt a wait-and-see attitude, delaying new projects in the capital. This could be a stimulus for development of regional projects, and such an effect is already being seen in the retail segment.

Offices and retail remain the most attractive commercial real estate segments, while hotels and warehouses are, on the whole, of less interest to investors.

Office

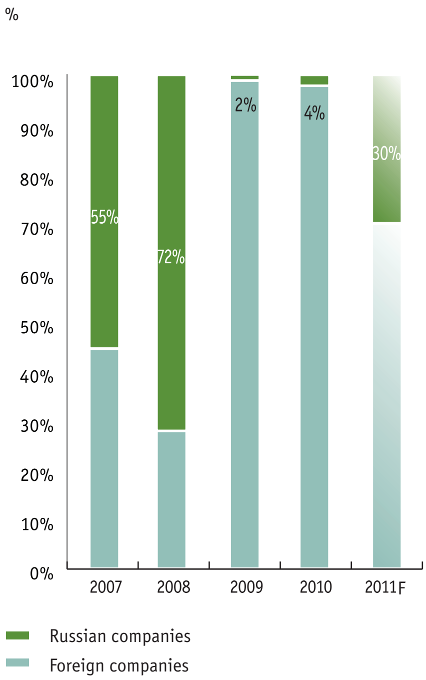
Lower investments in the office segment compared with retail since the start of 2011 are explained by the fact that several large office deals are still at the negotiation stage. Completed transactions include sale by Coalco of almost the whole of its stake (about 47%) in the White Square and White Gardens office complexes to VTB-Capital. The principal investor was the American company TPG Capital.

Lack of dynamism on the office investment market has a number of causes, but is particularly due to shortage of quality projects with central location for both lease and sale, accompanied by increasing demand and shrinking supply of new space.

Demand for premium office real estate is at customary high levels and rental rates have seen major growth (by about 10% each quarter since the start of the year). Rates for properties at a distance from the centre are fairly stable and have seen little change since the end of 2010.

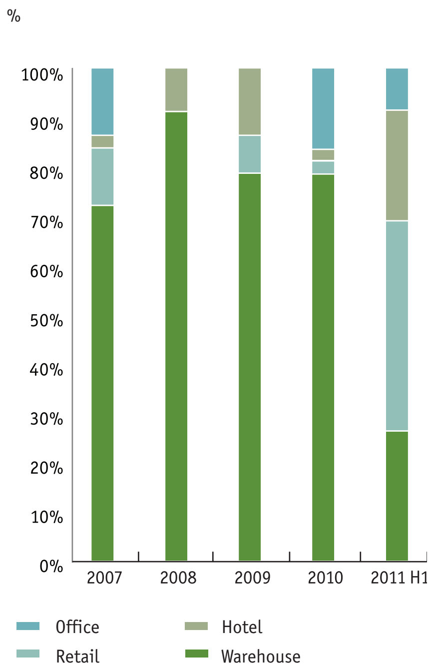
These factors are impacting the investment component as sustained and growing demand in a context of limited supply leads to higher market valuations and lower levels of risk for investors. Cap rates are coming down as a result, but we do not expect the effect to be large-scale (decline by about 0.5 p.p. for the year seems probable).

Return of foreign investors to the Russian market became evident in 2011



Source: Knight Frank Research, 2011

The retail segment led by sales volumes in H1 2011 with 43% of the total



Source: Knight Frank Research, 2011

Largest sales transactions in commercial real estate during H1 2011

Buyer	Seller	Assets	Transaction value
Hals-Development (former Sistema-Hals)	Intourist	Hotel Peking on Bolshaya Sadovaya street, 135 rooms.	$40-45 mln
AMAKS Hotels & Resorts	-	Tourist Hotel in Krasnoyarsk	$10 mln
Verny Capital	Capital Partners	Ritz-Carlton Hotel on Tverskaya street	$700 mln
Nisanov, Iliev	Ministry of Defence	Soyuz Hotel on Universitetsky avenue	$16 mln
Intertorg	Fleming Family&Partners	Class-A warehouse complex in Saint Petersburg (14,650 sq m total space)	$14 mln
Minoriities: Giffels Van Riet Capital and Latidge Investments Limited	Karta Realty Ltd	South Gate Industrial Park in Moscow Region 76,500 sq m total space)	$54.5 mln
Hines Global REIT	AIG European Real Estate Partners	FM Logistic warehouse complex in Khimki (75,000 sq m total space)	$80 mln
TVOE Holding	PNK Group	Automated warehouse at the PNK-Chekhov logistics park (24,000 sq m total space)	$21.5 mln
VTB	Mirax Group	Floors in the Western Tower of the Federation Complex in Moscow City	$100 mln
Aliv-M	Sadko business centre	Sadko class-B office complex on Zemlyanoy Val street	$70 mln
VTB-Capital, TPG Capital	Coalco	A stake of about 47% in the Belaya Ploschad business centre (111,000 sq m total space), and the Beliye Sady project (105,000 sq m total space)	$675 mln including debt
Sberbank	Sibir	Business centre in Novosibirsk (11,200 sq m total space)	$20-22 mln
Promsvyaz Nedvizhimost	TNK-BP	Alfa-Arbat Centre class-A business centre (over 47,000 sq m total space)	$230 mln
Fort Group	-	The company Macromir , which has 5 operating shopping malls and 1 mall under construction in Saint Petersburg	$650-700 mln including debt
M.Square Holding Ltd	Anafi Enterprises Ltd and Sarnatus Trading Ltd	4 MosMart hypermarkets on Borovsky, Yaroslavsky, Dmitrovsky and Volokolamsky highways	$566 mln
BIN Group	MCG and Z-Build	Kaluzhsky shopping mall (57,000 sq m total space)	$190 mln
Kompleksnye Investitsii	MTZ Rubin	Gorbushkin Dvor shopping mall (60,000 sq m total space) and Filion shopping mall (128,000 sq m total space)	$450 mln
SOK Retail Int. Oy	Adamant	4 shopping and leisure malls in Saint Petersburg	$130 mln
Torgovy Kvartal	London & Regional Properties	SanMart shopping mall in Kaluga (47,000 sq m total space)	$80 mln
Torgovy Kvartal	-	Mixed-use complex in the town of Stupino in Moscow Region (32,000 sq m total space)	-
Hals-Development (former Sistema-Hals)	Emmomax International NV	Shares of Citer Invest BV, which has development rights at Sector 11 of Moscow City: a mixed-use complex (228,000 sq m total space) and a transport terminal (64,000 sq m total space)	$100 mln

Source: Knight Frank Research (based on open sources), 2011

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Moscow

Retail

Transactions in the first half of the year were concentrated in the retail segment, where investment volume increased tenfold y-o-y in H1 2011 and the number of deals tripled. Much faster increase of overall volume compared with deal number points to substantial growth of average transaction size this year. Acquisition of Gorbushkin Dvor and Filion shopping malls by the company Kompleksnye Investitsii was the biggest deal on the Moscow market in the last five years.

This surge of investments is probably explained by high levels of deferred demand, as confirmed by the very small number of deals contracted in the previous two years. Purchase of a functioning shopping mall requires large up-front investments, which have been impracticable in the last two years due to liquidity shortage.

More affordable financing has made developers and retailers more active, but business opportunities on the Moscow market are limited for all players at present and hardly any new retail projects have been announced in the capital. Most of the shopping malls currently under construction in the city were begun before the crisis and are mainly near to completion with tenants ready to move in.

These factors increase probability that developers and retailers will shift their business focus to regions away from Moscow. The company Torgovy Kvartal has bought a mixed-use complex, which is under construction in the town of Stupino, and a 47,000 sq m operating retail and leisure mall in the city of Kaluga (the Company plans to build the second phase of the project). A number of new projects have also been announced in regional cities since the start of the year, including the planned 100,000 sq m Aura shopping and leisure mall in Surgut, to be implemented by Renaissance Development.

Hotels

There has been an increase of investment and developer activity in the hotel segment recently, and a number of transactions for landmark properties in the capital have been closed since the start of the year. These have included sale by Capital Partners of the Ritz Carlton Hotel to the company Verny Capital, although affiliation between buyer and seller makes investment character of the transaction dubious.

A number of international hotel operators have also announced plans in the last six months for expansion of their presence in Russia, including plans to enter regional markets.

In spite of the positive trend, investment demand for hotels remains weaker than for other commercial real estate segments, mainly due to long payback periods of hotel projects. However, hotel assets are promising as long-term investments because they can be quickly adapted to a shifting market environment and thus offer relatively steady returns despite changes in operating conditions.

Hotel investment policy by market players has become more thoughtful. Before the crisis hotel assets were often viewed as a means of risk diversification and they were acquired as opportunities arose, rather than as part of a pre-planned development strategy. This has now changed, with most investors playing a longer game and being more scrupulous in their choice of projects.

Warehouse

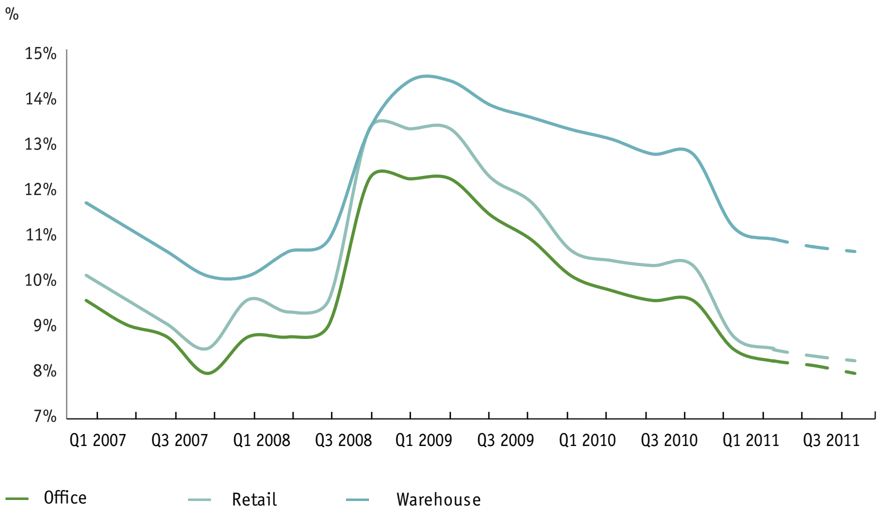
The warehouse segment also finds less favour with investors than other types of commercial real estate, despite low entry thresholds. However, specifics of the warehouse segment make it more appealing to foreign capital. There were two warehouse transactions with foreign capital in the first half of the year. In one of these transactions the minorities, Giffels: Van Riet Capital and Latidge Investments Limited, bought the South Gate Industrial Park, which is one of the biggest warehouse sites in Moscow Region.

Lack of quality properties is a key issue on the warehouse market at the present time. Only 65,000 sq m of quality warehouse space was brought into operation in the first six months of 2011, and we expect growth of supply in the whole of 2011 to be only 350,000 sq m, which will be the lowest figure in the last seven years.

Low supply is in contrast with growth of demand for warehouse property as retail business turnover increases. The vacancy rate at class-A sites fell from 5% to 3% in H1 2011 and urgent need of companies for warehouse space has led to reappearance of provisional rental agreements.

In these circumstances appeal of the warehouse segment was bound to increase, and this trend has been confirmed by transactions on the market during recent months.

Cap rates in commercial real estate segments will continue to decline in 2H 2011



Source: Knight Frank Research, 2011

Forecast

We consider that maintenance of investment rates at current levels will give $6 billion overall investments in commercial real estate for 2011, which will be a record for the Russian market.

Several transactions involving foreign investors are now being finalized, so we expect increase in the share of transactions with foreign capital to 30% by the year-end. Also, several western investment funds have expressed interest in the Russian market, it is quite possible to see the same predominance of foreign investors in the medium term as was before financial crisis.

During the last two years the commercial real estate market has been subject to a lack of liquidity and high levels of development risk, so that new projects have not been undertaken. All segments, with the exception of hotels, are now seeing unprecedentedly low levels of supply, which makes a deficit of quality space in 2012-2013 very probable. This would lead to growth of rental rates.

Improvement of lending terms could change the situation for the better, but initiatives by Moscow mayor to limit construction of commercial projects inside the Third Transport Ring and the overall mood of uncertainty have led to a situation where the flow of development projects is not significantly increasing, despite expansion of project financing. It's quite possible that the current situation could remain in place until the end of the year at least.

OVERVIEW

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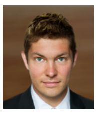

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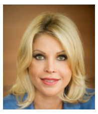

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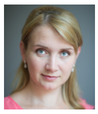

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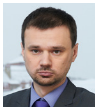

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Established in London more than a century ago, Knight Frank is the renowned leader of the international real estate market. Together with Newmark Company, Knight Frank's strategic partner, the company encompasses 243 offices in 43 countries across six continents.

Knight Frank has been a symbol of professionalism for tens of thousands of clients all over the world for 116 years. After 16 years, Knight Frank has become the leading company in the commercial, warehouse, retail and residential real estate segments of the Russian real estate market. More than 500 large Russian and international companies in Russia have already made use of the company's services.

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