

RESEARCH



H1 2019  
**INVESTMENT  
MARKET**  
Russia

## KEY FINDINGS

The total volume of investments amounted to 78 bln rub. in H1 2019, which is 4% more than a year ago.

Investor interests have shifted toward the sector of land plots for development. Its share amounted to 31% of all investments.

Developers became the key property investors, with their share amounting to 36%.

The share of foreign investments dropped by 21 p.p. to 30% as compared to H1 2018.

# INVESTMENT MARKET



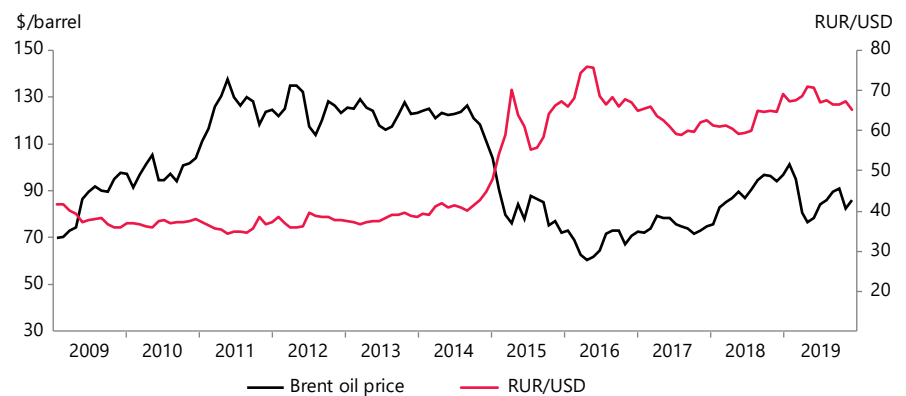
**Igor Roganovich**  
Head of Capital Markets,  
Knight Frank

*"The volume of investments into Russia remains reserved but appears to have a consistently positive performance. The established balance in the key sectors of the market is a driver for the investor activity. The residential property investments are increasing despite the latest changes to the Federal Law regarding the shared-equity construction, which affects substantially the project implementation model. The current economic situation and its forecast condition by the end of the year do not generally have a negative effect on the investment behavior. Meanwhile, what causes concern is the growing capital outflow that is able to affect the investment resource in the property market."*

The key indicators of the Russian economy proved to be lower than expected in H1 2019 as some of the planned figures turned out to be hard to achieve. The economic growth amounted to 0.8% in Q2 2019 and to 0.7% since the beginning of the current year. The official forecast for the Russian GDP was cut from 1.2–1.7% to 1–1.5%. A similar change happened with the assessments by World Bank and Fitch Rating Agency, both of which changed their expected annual figure from 1.4% to 1.2% and from 1.5% to 1.2%, accordingly. The inflation amounted to 2.46% over the first six months of 2019 in Russia as compared to December 2018 and stood at 4.66% YoY. A slowdown in the price

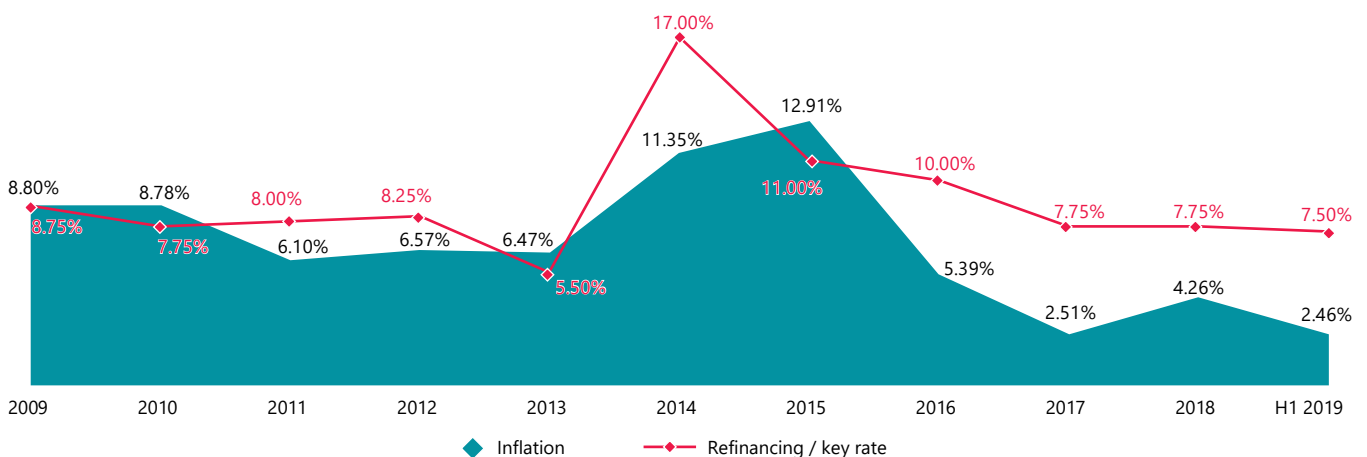
growth was recorded in June. The Central Bank of Russia cut its forecast for the annual inflation from 4.7–5.2% to 4.2–4.7%. The Ministry of Economic Development and Trade expects the figure to stand at 4.3%, while the optimistic scenario puts the inflation under 4% in 2019. The Central Bank of Russia decided to cut the key rate further on in June, when it reduced it to 7.5%, which was followed by another cut to 7.25% in July. The long-term sovereign rating of Russia according to S&P Global Ratings (S&P) remained unchanged, namely investment-grade BBB- with a positive outlook. Moody's also made no amends to its assessment of Russia's investment rating, i.e. Baa3 with a positive

Historical data of Brent crude oil prices and US dollar exchange rate



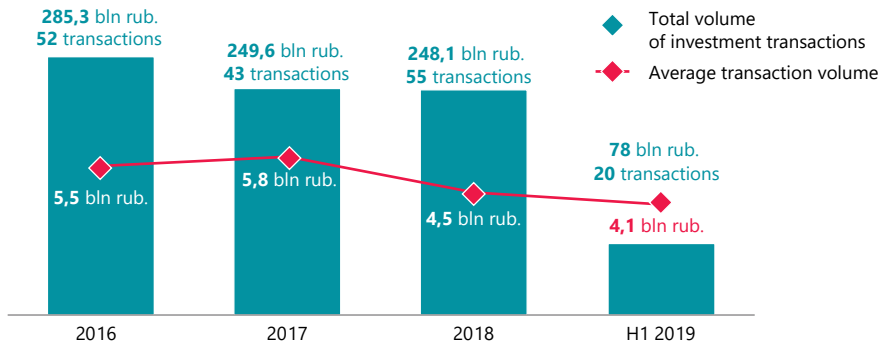
Source: Knight Frank Research, Центральный банк РФ, 2019

Inflation rate and key rate



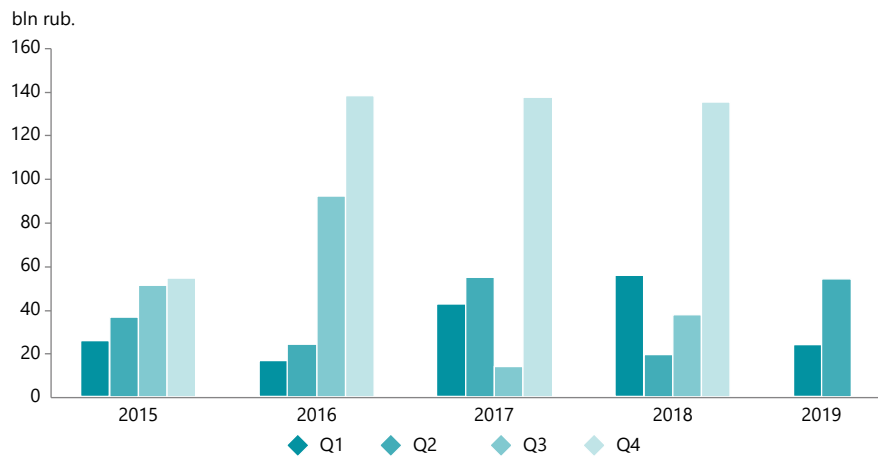
Source: Central Bank of the Russian Federation, 2019

Key figures



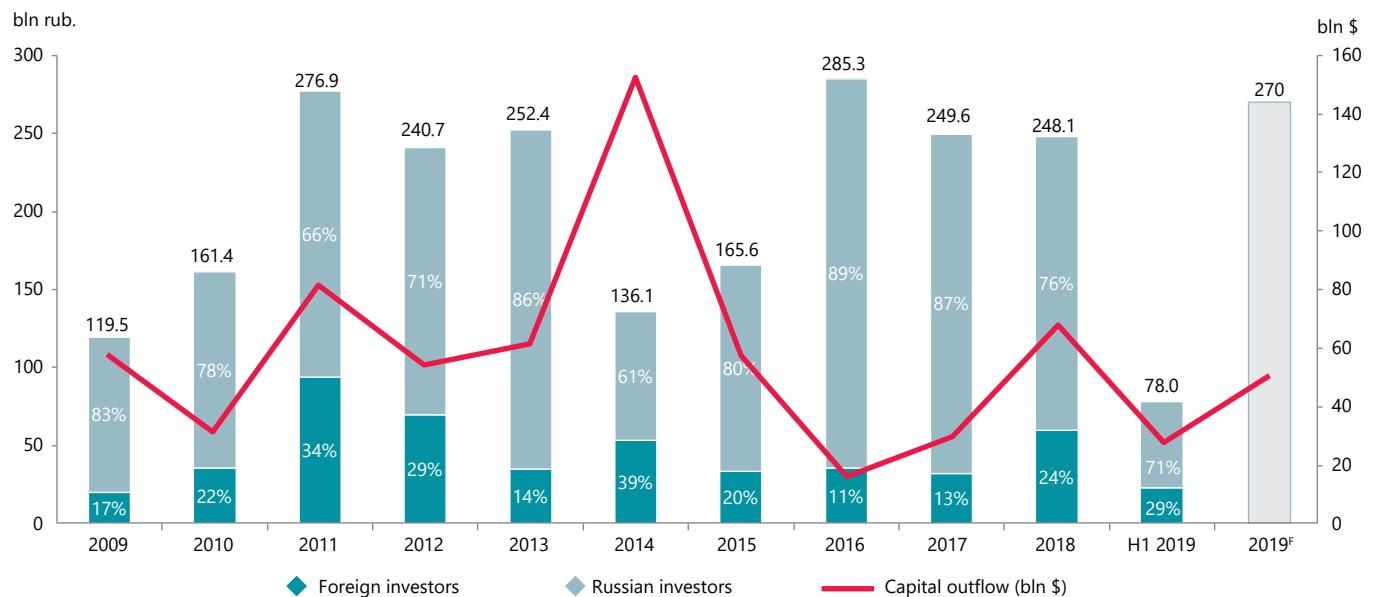
Source: Knight Frank Research, 2019

Investment volume increase by quarters



Source: Knight Frank Research, 2019

Investment volume in commercial real estate (bln \$) / Capital outflow (bln \$)



Source: Knight Frank Research, 2019

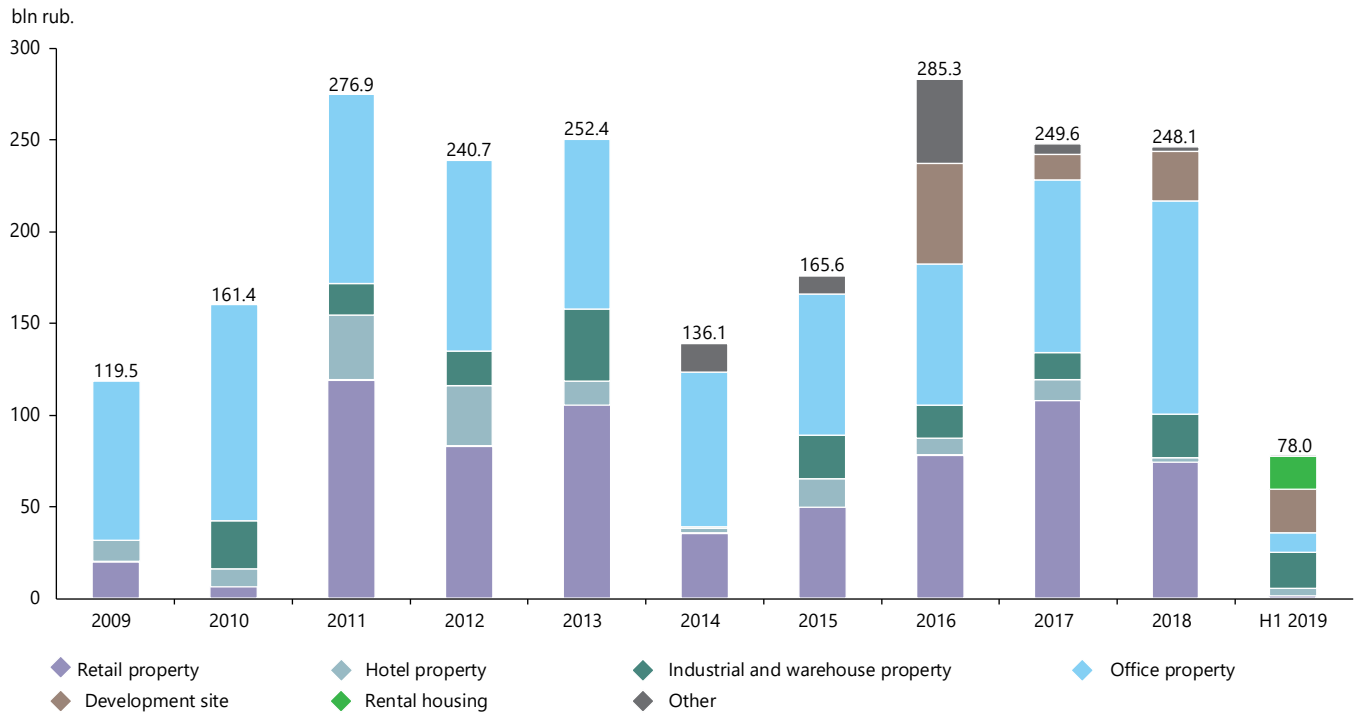
outlook. In its turn, Fitch reconsidered its position as based on the results of the past six months and changed Russia's foreign currency credit rating from BBB- to BBB, with a positive outlook. Among the factors that have affected such a change there was an improvement in the macroeconomic certainty in Russia as well as the reduced economic dependency of the oil prices and augmented resilience to external shocks. The capital outflow has significantly exceeded the level forecast by the Central Bank of Russia, just like last year. Thus, the figure amounted to about \$27 billion in H1 2019, which is more than the figure expected by the Central Bank of Russia (\$20 billion). Considering this fact, the expectations of the Central Bank of Russia regarding the annual capital outflow were subject to correction and now stand at \$50 billion. However, the actual annual figure may exceed the forecast, which will affect the key sectors of the economy.

The total investments into the Russian property amounted to 78 billion rubles in H1 2019, which is 4% more than a year ago. Despite such an insignificant increase, we expect to see some major transactions including portfolio transactions, which will be the key factor contributing to the growing volume of annual property investments.

Just like the past three years, the largest share of the annual volume of investments into the Russian property is likely

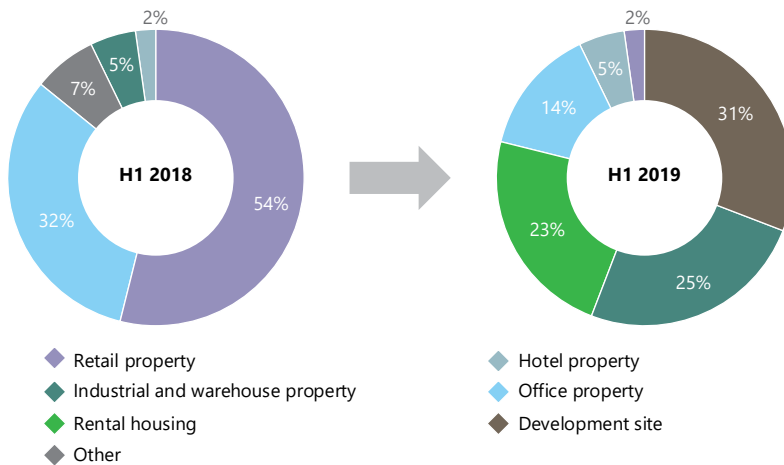
# INVESTMENT MARKET

## Quarterly growth of investment volume by sector



Source: Knight Frank Research, 2019

## Investment structure by segments



Source: Knight Frank Research, 2019

## Динамика объемов инвестиционных сделок по сегментам (по сравнению с 1 полугодием 2018 г.)

Development sites	+699%
Industrial and warehouse property	+181%
Hotel property	+94%
Office property	-68%
Retail property	-89%

Source: Knight Frank Research, 2019

to account for H2 of the year. Considering the forecast volume of investments at 260-280 billion rubles, we are likely to see a number of major transactions amounting to about 200 billion rubles in total in H2 2019.

The structure of investment demand underwent significant changes in H1 2019. Thus, the office market lost its leadership, while the largest share of investments account-

ed for land plots for development. The total investment volume into the land plots amounted to almost 24 billion rubles, while the sector's share of annual investments stood at 31% in H1 2019. The volume of investments into this sector of the market has already come close to last year's figure (28 billion rubles). Among the most significant transactions that contributed to the leadership of the sector there was the purchase of the rights to develop a master

planned community project of the former Likhachev Plant by Etalon Group. Industrial and warehouse property came in second by the volume of investments. However, it happened only due to one major transaction of the sector, namely the sale of a General Motors Plant in St. Petersburg to Belorussian investors. Therefore, the share of the sector amounted to 25% against 5% in H1 2018. A relatively new investment sector of rental housing investments for fur-

ther lease rounds out the top three list. Undoubtedly, similar transactions have taken place before, however, currently we can state the fact of their becoming a solid investment tool. Thus, Alfa Group purchased a residential complex under construction Prime Park in Leningradskiy Avenue and DOM.RF bought a part of Serdtse Stolitsy Residential Complex and Level Amurskaya to build their rental housing portfolio further on. The offices accounted for 14% in investments (an 18 p.p. decrease yoy), the hotels – for 5% (a 3 p.p. increase yoy), and the retail property – for 2% (a 53 p.p. decline yoy), over the period under consideration.

The geographic segmenting of the property investments generally corresponds to the structure of H1 2018. The property investments amounted to 73% in Moscow,

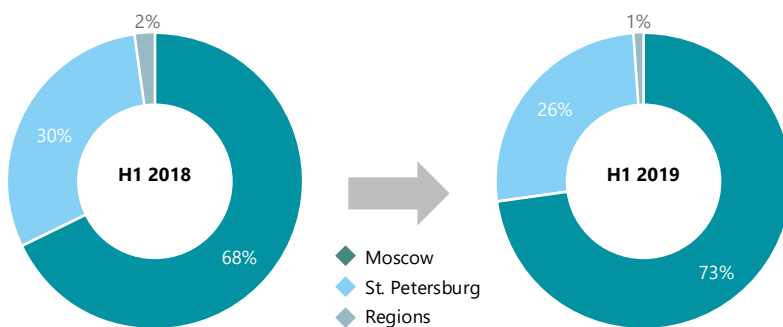
which is 5 p.p. more than a year earlier. The share of investments into the property of St. Petersburg amounted for 26%, which is 4 p.p. less than last year. Only 1% of investments accounted for large regional centers, among which there were Voronezh and Nizhniy Novgorod. Such breakdown of demand is likely to last through the end of the year.

Taking into consideration a significant increase in transactions with development sites, the most active investors proved to be developers, with their share of investments amounting to 36%. Foreign investors, just like in 2018, in general, kept their second position in H1 2019, their share being basically identical to that of last year (25%). Investment companies came in third, with their share amounting to 21%.

As of H1 2019, the share of Russian investors in the structure of total investments amounted to 70% against 49% in H1 2018. Despite the decline in the share of foreign investments, the structure of H1 2019 is expected to last throughout the end of the year. Therefore, the share of foreign investments will remain about 30% by the end of the year, which generally corresponds to the situation of 2018. The international investors were represented only by two countries. i.e. Belorussia and Malta in H1 2019.

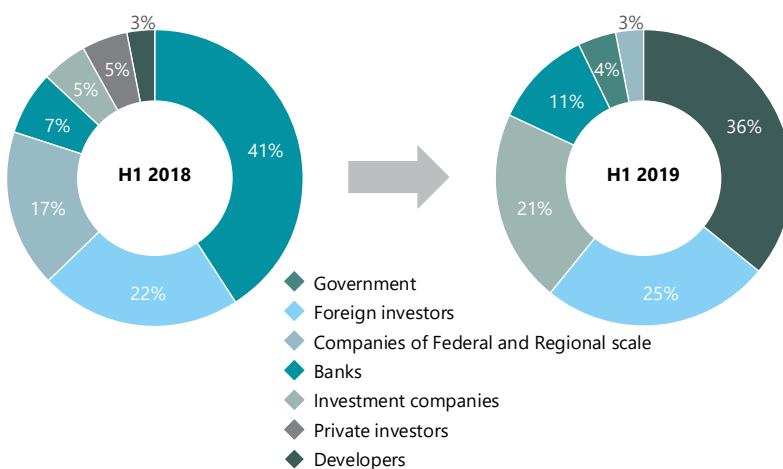
The cap rates remained flat over the past six months. As of H1 2019, the cap rates range for first class assets amounted to 9.50–10.50% for offices, 9.75–10.25% for retail property, and 11.50–12.00% for industrial and warehouse property.

Investment structure by regions



Source: Knight Frank Research, 2019

Investment structure by investors type



Source: Knight Frank Research, 2019

KEY INVESTMENT TRANSACTIONS WITH RUSSIAN COMMERCIAL REAL ESTATE IN H1 2019:

OFFICE REAL ESTATE

The purchase of one building in Aquamarine III by Gazprombank for **4.45 bln rub.**

RETAIL REAL ESTATE

The purchase of space in SC Valdai (3,600 sq m) by Detskiy Mir. The investment volume – **1 bln rub.**

INDUSTRIAL AND WAREHOUSE REAL ESTATE

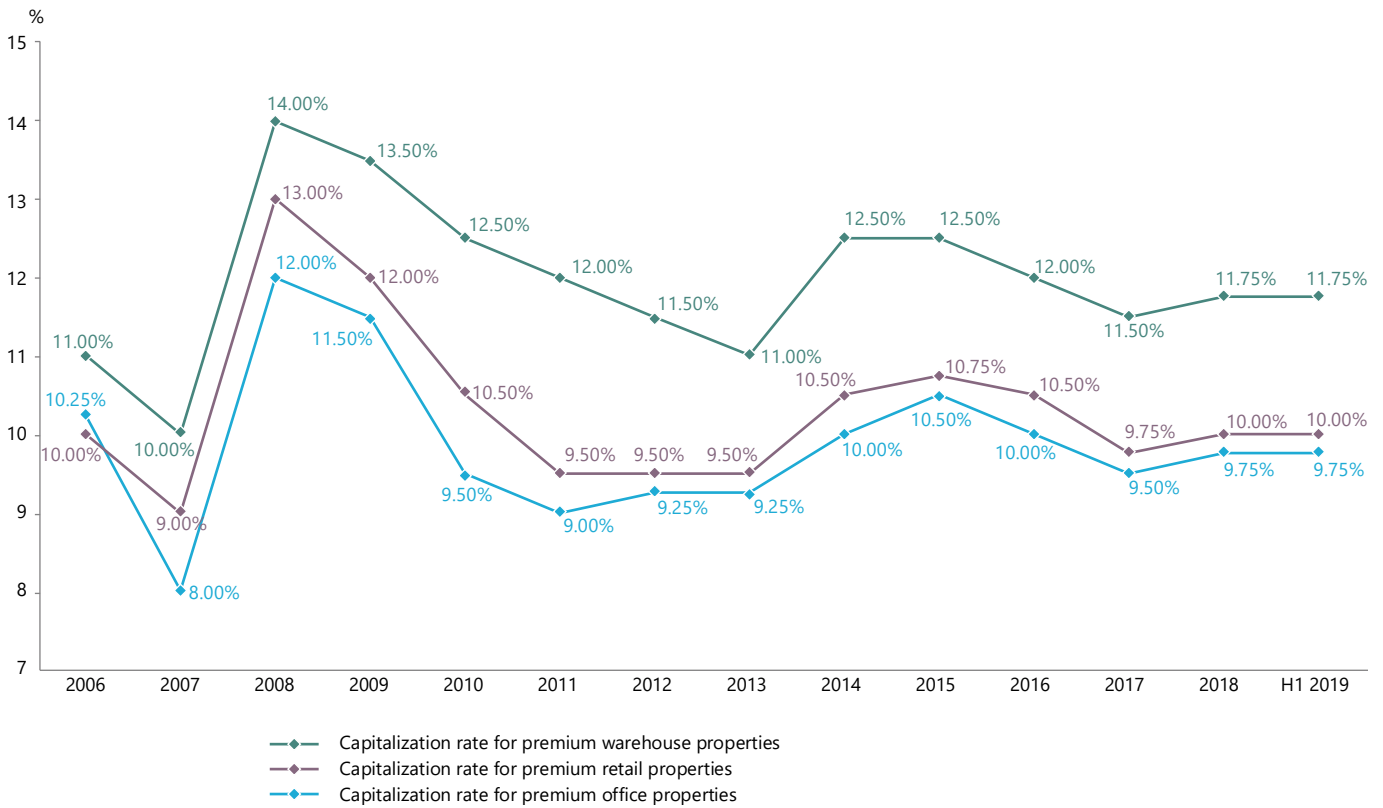
The sale of General Motors plant in Shushary for about **\$300 mln.**

DEVELOPMENT SITES

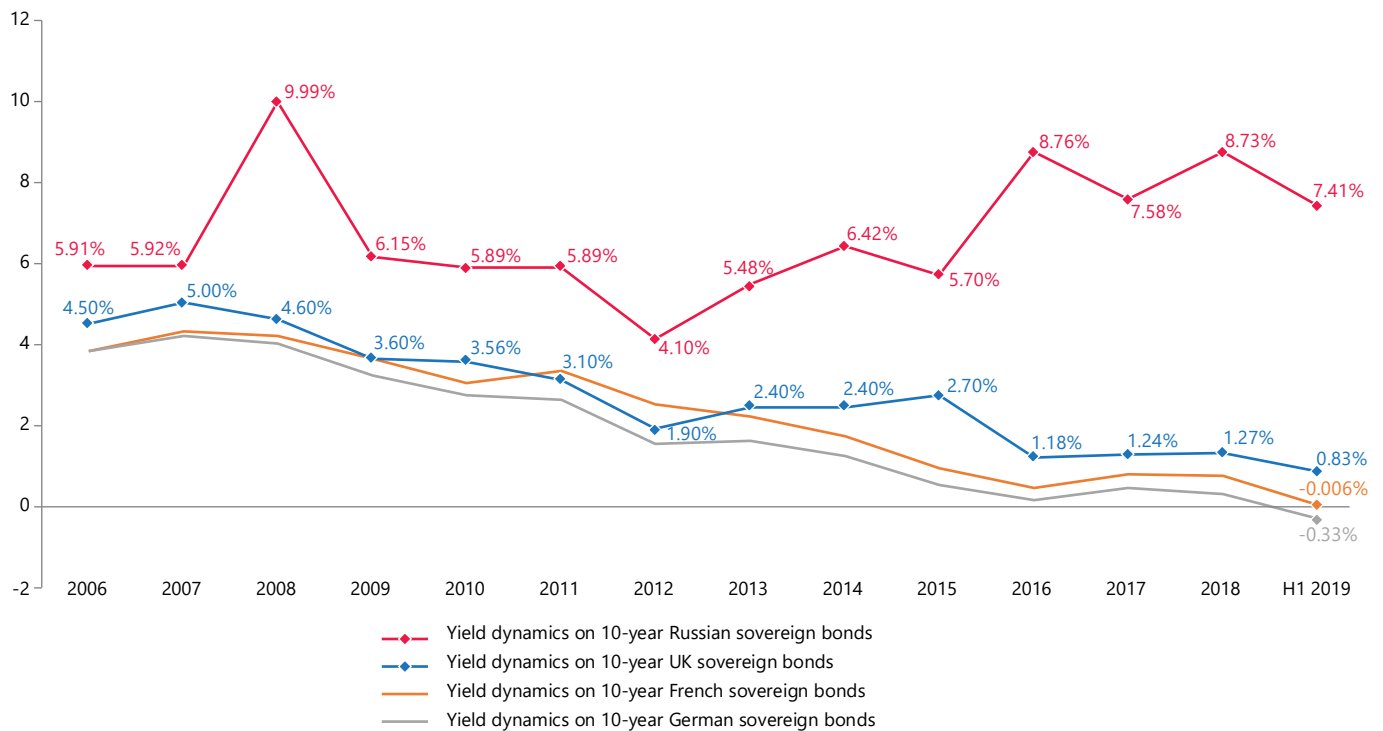
The purchase of part of the ZiL project by Etalon group, **17–18 bln rub.**

# INVESTMENT MARKET

## Capitalization rate for premium commercial real estate properties



## Yield dynamics on 10-year sovereign bonds



The following figures depict the yields dynamics of 10-year government bonds of the UK, France, Germany and Russia in currency terms, as well as the cap rate movements for prime office, retail and warehouse property in rubles (considering the current market conditions).

Source: Knight Frank Research, Investing.com, 2019

OFFICE  
REAL ESTATE

10.8 bln rub. ▼

TRANSACTIONS VOLUME

1.8 bln rub. ▼

THE AVERAGE DEAL SIZE

9.5–10.0% ▶

CAPITALIZATION RATE

RETAIL  
REAL ESTATE

1,5 bln rub. ▼

TRANSACTIONS VOLUME

0.8 bln rub. ▼

THE AVERAGE DEAL SIZE

9.75–10.25% ▶

CAPITALIZATION RATE

INDUSTRIAL  
AND WAREHOUSE REAL ESTATE

19.7 bln rub. ▲

TRANSACTIONS VOLUME

9.8 bln rub. ▲

THE AVERAGE DEAL SIZE

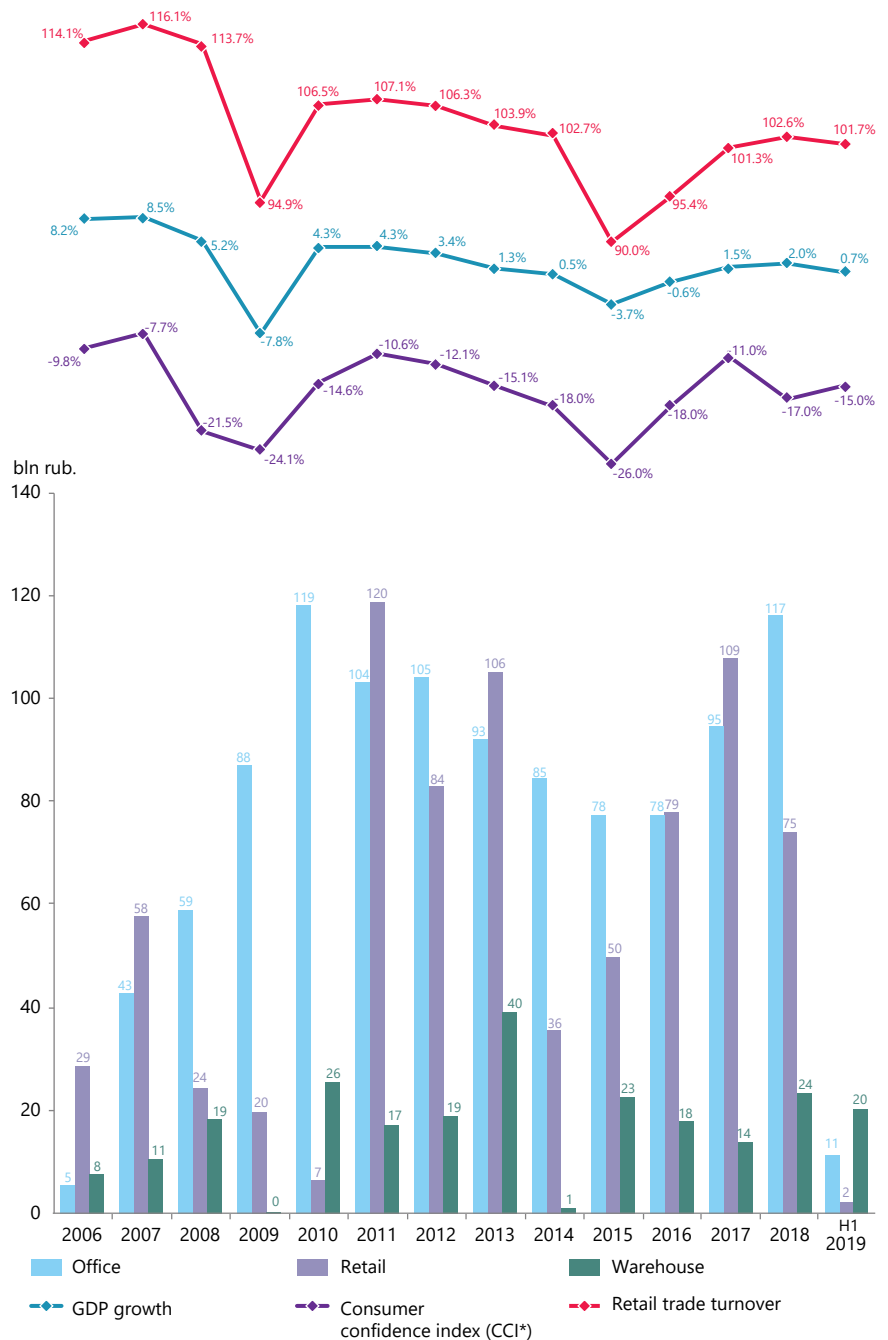
11.5–12.0% ▶

CAPITALIZATION RATE

Change as compared with the H1 2108

▲ – increase, ▼ – decrease.

Investment volume dynamics in real estate and GDP growth dynamics



Source: Knight Frank Research, Ministry of Economic Development of the Russian Federation, 2019

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RESEARCH

Olga Shirokova

Director, Russia & CIS

Olga.Shirokova@ru.knightfrank.com

CAPITAL MARKETS

Igor Roganovich

Director

Igor.Roganovich@ru.knightfrank.com

+7 (495) 981 0000