

2014

OFFICE MARKET REPORT

Saint Petersburg



HIGHLIGHTS

New high-quality space delivery has slowed down with its index dropping by 33% compared with 2013.

A drop in vacancy rate by 6.3 p.p. has been noted in Class A business centers amounting to 16.2% at the end of the year.

Having grown by 1.5 p.p., the vacancy rate in Class B business centers at the end of 2014 was 8.8%.

The take-up of high-quality office space in 2014 amounted to 128.7 thousand sq m. Thus, in comparison with the previous year, the total leased area has increased by 18% or 19.5 thousand sq m.

Compared with Q4 2013, the average weighted rental rate in Class A business centers remained unchanged, in Class B business centers – has dropped by 9% at the end of Q4 2014.



Marina Puzanova
Head of Offices Department,
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"The past year, particularly Q4, was rather challenging, with traditional rapid response of office real estate market to these economic changes. The trend that has just started to take shape in the beginning of the year, where tenants wished to get a fully prepared high-quality product at a reasonable price, has strengthened by its end, becoming almost the only possible strategy for leasing out newly delivered facilities.

However, the main adjustments of market indicators are of course yet to follow: expenses optimization is becoming a priority for many companies, while adequate response to the needs of tenants will be the task of business centers' proprietors. Changes of demand structure will alter both rental and vacancy rates. Proprietors will have to demonstrate highest levels of professionalism to preserve current tenants and twice the effort – to attract new ones".

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Key indicators. Dynamics.*

	Class A	Class B
Total high-quality business centers' space stock, thousand sq m	2,184	
including, thousand sq m	765.1 ▲ +10%	1,419 ▲ +3%
Delivered in 2014**, thousand sq m	144	
including, thousand sq m	96.7	47.3
Vacancy rate by the end of Q4 2014, %	16.2 ▼ -6.3 p. p.	8.8 ▲ +1.5 p. p.
Asking rental rates in operating business centers, rub./sq m/month including VAT and OPEX	990–2,985 0	600–2,200 ▼ -4%

* Compared with Q4 2013 figures

** Business centers built for own use and those offered for sale on the market not included

Source: Knight Frank St. Petersburg Research, 2015

Key events

- ♦ Class A business centers Trinity Place, Electro and Zeppelin are fully leased out to Gazprom Company. The development company GHP Group owns two objects.
- ♦ Several office centers acquisition transactions took place. The business centers were mostly purchased by end-users for own use, including such objects as Troubetzkoy, Litera and Apollo located in the central districts of St. Petersburg.
- ♦ An official opening of the following business centers (total area of each exceeds 15 thousand sq m) took place: Electro, Trinity Place, SetCenter, Eightedges, Victoria Plaza (1st stage), Lukoil Company office building.
- ♦ Because of the weakening of the ruble, a number of business centers' proprietors, who previously indicated commercial terms in foreign currency, switched to rubles.

Supply

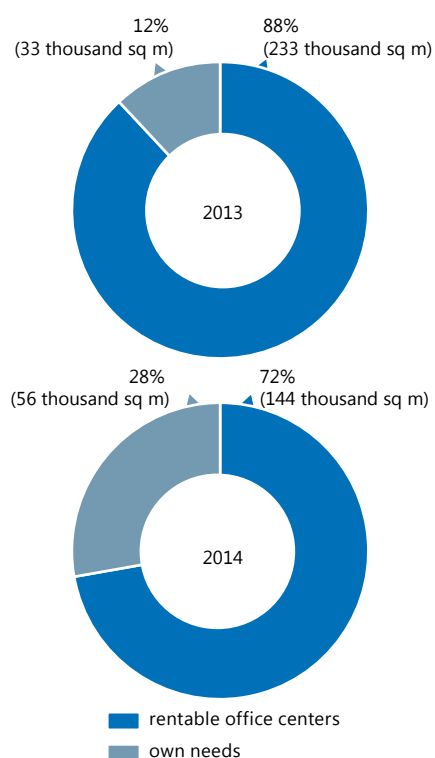
At the end of 2014, the total leasable area of high-quality business centers in St. Petersburg amounted to 2,184 thousand sq m. Class B business centers still constitute the greatest share of supply stock on the market – 65%.

Including the high-quality office centers with the total area of more than 200 thousand sq m used by companies for their own needs, the total leasable area of high-end commercial real estate is 2,390.7 thousand sq m.

200.4 thousand sq m of high-quality office space were delivered over the past year.

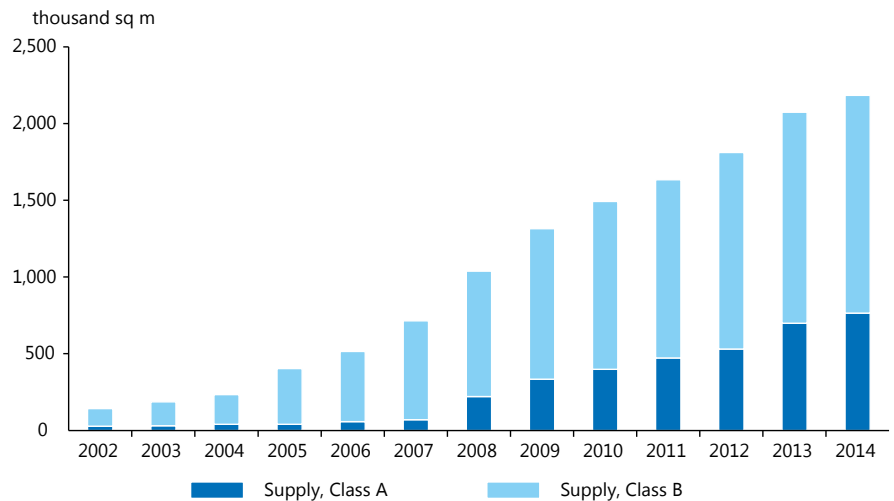
The largest share of new supply (72% or 144 thousand sq m) falls to office centers available on the lease market. New office space delivery pace has slowed down by 33% compared to 2013. This in part resulted from delivery postponement of a number of business centers such as Formida, Krummel House, Senator (60 Moskovsky Avenue), 2nd stage of Senator (1 Kropotkin Street), two office buildings of convention and exhibition center Expoforum, Flandria Plaza and others to 2015.

New supply delivery in 2013 and 2014



Source: Knight Frank St. Petersburg Research, 2015

Dynamics of the total leasable space in high-quality business centers, 2002–2014



Source: Knight Frank St. Petersburg Research, 2015

Business centers delivered in 2014 with the area of over 10 thousand sq m available for lease

Name	Address	Class	Total office space, thousand sq m	Leasable office space, thousand sq m
Trinity Place	22 Admiral Lazarev Emb	A	37.4	27
Eightedges	45A Malookhtinskiy Ave	A	20.1	13.2
Electro	156 Moskovskiy Ave	A	18	15.7
Victoria Plaza (1 st stage)	2A Pobedy Square	B	20	15
Pulkovo Star	28A Pulkovskoye Hwy	B	14.5	12.4

Source: Knight Frank St. Petersburg Research, 2015

Business centers built for own use with the area larger than 2 thousand sq m delivered in 2014

Name	Address	Class	Total office space, thousand sq m	Leasable office space, thousand sq m
Airport	41ZI Pulkovskoye Hwy	B	13	10.6
Enigma*	59V Stachek Ave	B	10.9	9.9
Runt	7A Grenaderskaya St	B	6.9	5.2
Politekhniceskij	21Z Gjatskaya St	B	4.9	4.2

* Partially for own use

Source: Knight Frank St. Petersburg Research, 2015

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Growth in the share of office buildings constructed for own use and available on the market for sale is worth a note. Over the past year, 10 such objects with the total leasable area of 56 thousand sq m appeared on the market. To compare, in 2013, only 2 such facilities with the total area of 33 thousand sq m were delivered.

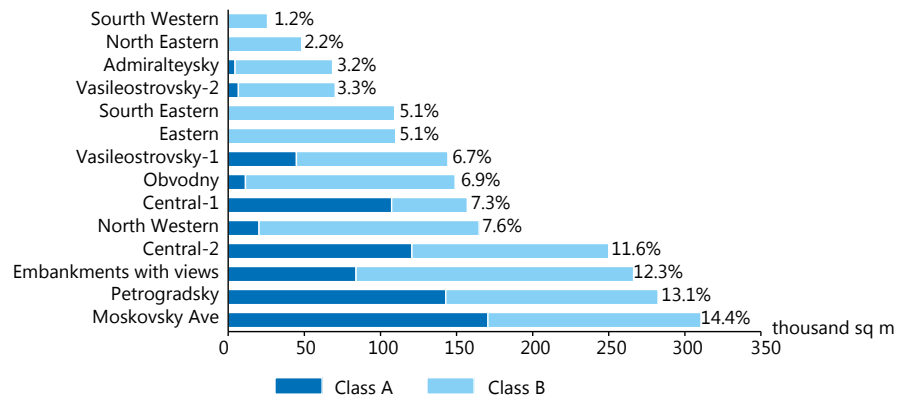
“Moskovsky Ave” business district is the leader in terms of leasable space: 14% of the total supply on the lease market is located here. At the end of 2014, the total area of high-quality business centers in this business district was 310 thousand sq m. The most active development of the district occurred in the last 3 years, during which the supply growth there has doubled.

Demand

At the end of 2014, the total office space available on the lease market was 248.7 thousand sq m or 11.4% of the total supply.

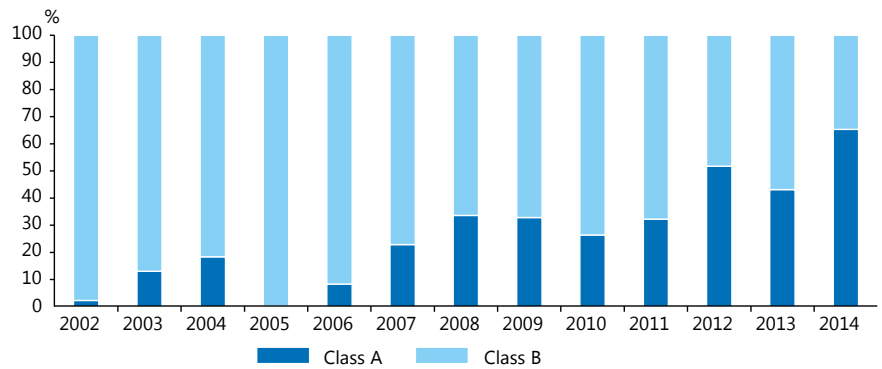
The vacancy rate in Class A business centers at the end of Q4 2014 was 16.2%. Compared with Q4 2013, the rate has dropped by 6.3 p. p. This shrinking of vacancy rates resulted from conclusion of major transactions in the segment of Class A business centers with oil and gas companies. Business centers Electro and Trinity Place with the total area of 59.4 thousand sq m were fully leased out.

Total leasable space distribution according to business districts of Saint Petersburg and the classes of business centers, Q4 2014



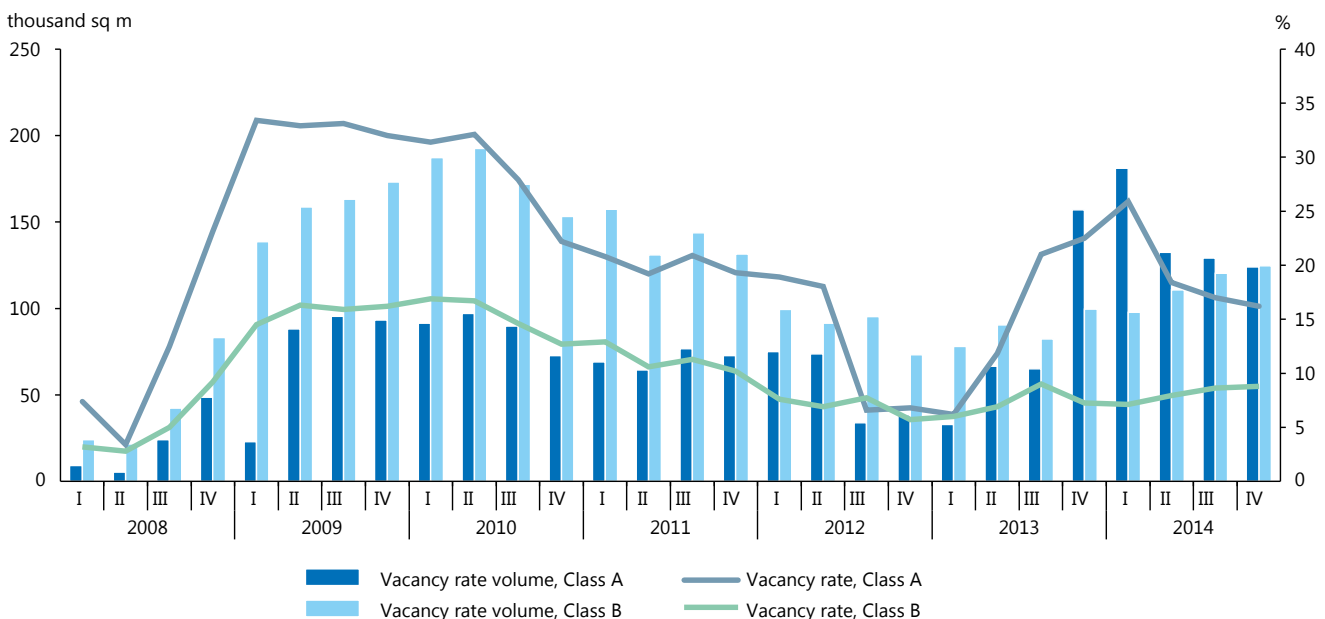
Source: Knight Frank St. Petersburg Research, 2015

High-quality business centers take-up dynamics, 2002–2014



Source: Knight Frank St. Petersburg Research, 2015

Dynamics of total vacant space changes and of vacancy shares according to classes, Q1 2008 – Q4 2014



Source: Knight Frank St. Petersburg Research, 2015

The vacancy rate in Class B business centers at the end of 2014 was 8.8%. During the year, this figure grew by 1.5 p. p. At the end of the year, tenants demonstrated increased activity: motivated by the wish to optimize lease expenses, they moved to smaller facilities or business centers with low rental rates.

The total take-up of high-quality space on the office market in 2014 was 128.7 thousand sq m. In comparison with the previous year, the total leased space grew by 18% or 19.5 thousand sq m. A trend of growing Class A business centers share in the take-up structure is associated with active relocation of Gazprom Company offices to St. Petersburg. Compared with 2013, the take-up of Class A office space has increased by 37 thousand sq m or 22 p. p., amounting to 65% (84.1 thousand sq m) in the total volume for 2014.

An increase in demand for the purchase of office buildings fueled by macroeconomic situation as a whole occurred in 2014. During the year, 10 sale/purchase transactions of office centers with the total leasable area of 111 thousand sq m was recorded. Of them 5 office buildings with the total area of 15 thousand sq m were purchased for own use. The small business center format occupies a strong market niche and is in steady demand with end users. The reasoning of office real estate buyers is not always economically justified: rather it is often based on their desire to reduce the risks of unpredictable rental rates growth and avoid insufficiently comfortable service in business centers.

The growth of primary sector companies' share is notable: oil and gas companies have

Key office space lease transactions concluded in 2014 with the area of over 1,000 sq m

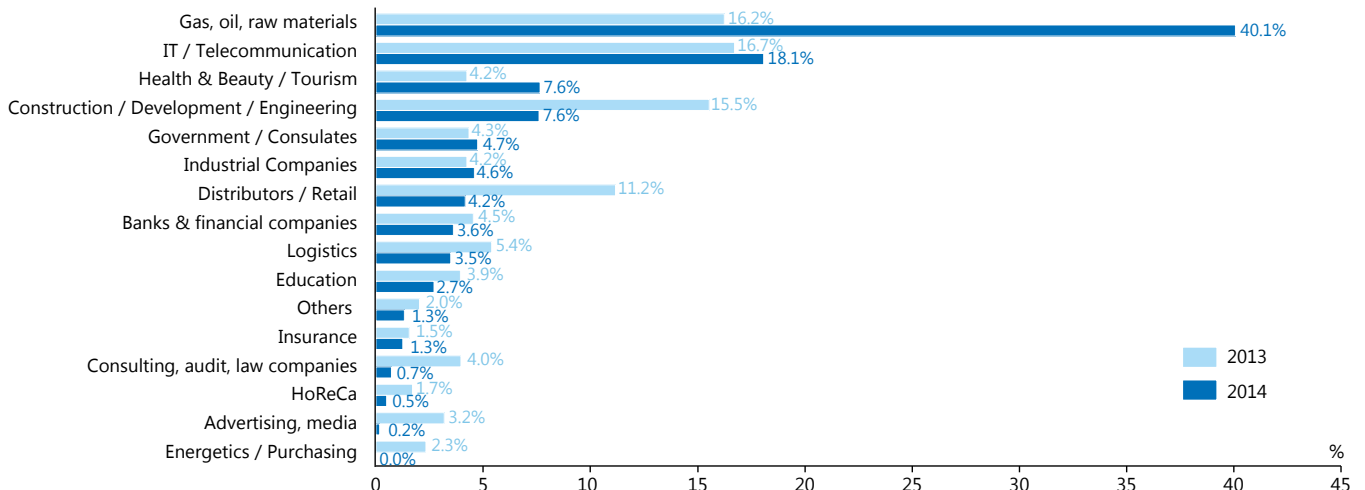


Source: Knight Frank St. Petersburg Research, 2015

accounted for 40% or 65.6 thousand sq m in office lease transactions structure. Whereas in 2013, such companies shared the first place with IT sector, accounting for 17% of transactions. However, a decline

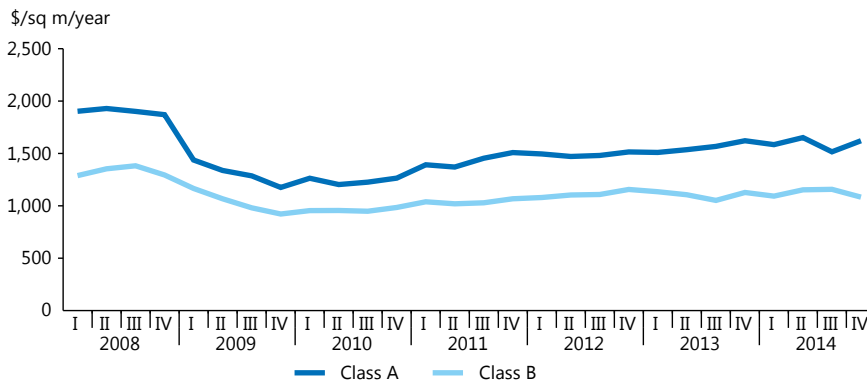
in interest towards office lease is notable with such business sectors as construction and development, distribution and retail, consulting, advertisement, energy and supply.

Distribution of leased space in high-quality business centers according to tenant profile



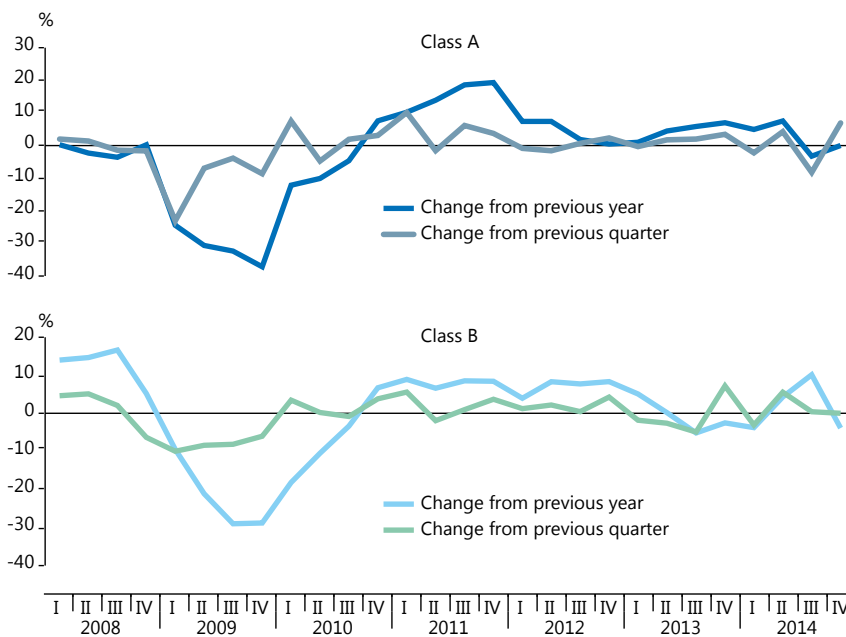
Source: Knight Frank St. Petersburg Research, 2015

Rental rates changes dynamics for Class A and B office facilities, Q1 2008 – Q4 2014



* Excluding VAT, including operating expenses
Source: Knight Frank St. Petersburg Research, 2015

Rental rates changes dynamics for Classes A and B compared over the period of Q1 2008 – Q4 2014 with quarter and year steps



Source: Knight Frank St. Petersburg Research, 2015

Commercial terms

The average weighted rental rate in high-quality business centers of Class A at the end of Q4 2014 amounted to 1,621 rub./sq m/month (including VAT and operating expenses). No changes occurred as compared with Q4 2013.

The average weighted rental rate in high-quality business centers of Class B at the end of Q4 2014 was 1,083 rub./sq m/month (including VAT and operating expenses). The rate has dropped by 9% compared to the figure of 2013. The drop in average

rate is associated with a growing number of business centers located remotely from the city center offering low rental rates.

Because of the weakening of ruble, a new trend can be observed on the market: some developers, who have previously nominated their rates in foreign currency (USD, EUR), are switching to the ruble equivalent. Furthermore, it should be noted that the developers/proprietors of office centers are ready to provide prospective tenants with discounts, lease holidays and perform finishing works.

Forecast

Delivery of about 330 thousand sq m of high-quality office space is expected during 2015. Should all the announced office centers be delivered until the end of the year, the total leasable area will exceed 2.5 million sq m.

Such a significant growth of new supply may affect vacancy rates: their growth of up to 17% is possible if by the end of 2015 the take-up will remain comparable with the figure of 2014. A drop in the amount of leased space of not less than 30% seems to be a realistic possibility. The tendency of acquisition of office centers for own use is likely to persist.

We expect that in 2015 the proprietors of Class A office facilities with high vacancy rates will offer customers discounts and favorable business terms. This factor will affect the average rental rate: it is predicted to gradually drop to 8%. No significant changes in commercial terms for Class B office centers are expected: in general, the rates will be stable.

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