

RESEARCH



Q1 2015
**OFFICE MARKET
REPORT**
Saint Petersburg

HIGHLIGHTS

Q1 2015 saw a 2% increase in the supply of high-quality office space, with 49,300 sq m delivered in new office buildings.

The construction and take-up levels were almost equal. However, the city's office vacancy rate remains high owing to slow take-up and relatively large amount of new office space coming onto the market in the previous periods.

The quarter witnessed a slight decline in the Class A office vacancy rate to 16%, with the Class B office vacancy rate rising to 11.1%.

The average face rents dropped in Q1 2015: Class A rents fell 8% and Class B rents decreased by 6%.

OFFICE MARKET REPORT SAINT PETERSBURG



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Q1 2015 results were consistent with our expectations. The office buildings slated for opening obtained permissions. However, their total area (and particularly that of speculative developments) was rather small, and with the existing take-up, the vacancy rate across both classes grew only slightly. It should be specifically noted that the Class A office vacancy rate remained almost unchanged, as office building landlords, who had learnt a lesson from the previous crises, were rather flexible when negotiating with their tenants, offering discounts on rents even under "tough" agreements. This trend was also supported by a decline in the average asking rents for Class A and Class B offices, which fell 8% and 6% versus Q4 2014, respectively. If there had been no compromise decisions made, the number of moves to new offices would have been significantly lower. Some companies tried to take advantage of the situation, occupying a larger space or leasing a higher-grade office without increasing their rental costs.

The tenant retention strategy certainly makes it harder to attract new customers to newly constructed office buildings. This has made a number of developers push back deadlines or even put the projects on hold. At the same time, the availability of high-quality office space for large tenants is rather low now, which has been caused by slow development of new properties and high demand for prime office space from Gazprom companies moving to St. Petersburg.

Key indicators. Dynamics.*

	Class A	Class B
Total rentable office space, thousand sq m	2,232.8	
including, thousand sq m	797.5	1,435.3
Change versus Q4 2014, %	▲ +2	▲ +1
Delivered in Q1 2015, thousand sq m	49.3	
including, thousand sq m	35.1	14.2
Vacancy rate by the end of Q1 2015, %	16	11.1
Change versus Q4 2014, p. p.	▼ -0.2	▲ +2.3
Asking rents at existing office buildings, rub/sq m/month, including VAT and OPEX	900–2,950	550–1,630
% change in average rents at existing office buildings versus Q4 2014	▼ -8	▼ -6

* Compared with Q4 2014 figures

Source: Knight Frank St. Petersburg Research, 2015

Supply

The gross leasable area of St. Petersburg's high-quality office buildings totalled 2.2 million sq m by the end of Q1 2015, which is double the level seen five years ago.

Class B offices still accounted for most of it (64%).

Seven office complexes totalling 49,300 sq m opened in Q1 2015, with Class A office space representing 65% of this area.

The first quarter of 2015 saw the continuation of a trend towards building office complexes for companies' own needs or for sale, which started in 2014. Such properties accounted for 57% of the total newly built office space. Completed speculative development projects added 22,000 sq m of new office space to the stock, which is 2.8 times more than in Q1 2014.

With 16% of the city's high-quality office space (345,000 sq m), the Moskovsky Prospekt business district is still at the top in terms of gross leasable area in St. Petersburg.

Availability of office space in St. Petersburg totalled 286,700 sq m as of the end of Q1 2015. The choice of high-quality offices is wide. The supply of openly marketed office space increased by 30% over the past quarter.

Active construction of Class A office space along with some other factors narrowed the gap between the total gross leasable area of Class A and Class B office buildings. In Q1 2015, the supply of Class B office space was 25% higher than that of Class A offices; this difference had been much larger over many years until 2013, reaching 90% at some points.

Key events

Q1 2015 marked the official opening of two Senator office complexes owned by Imperia Holding Company: the final phase of the office development on Kropotkinskaya Street and Phase 1 of the office building on 60 Moskovsky Prospekt. Besides, Gazprom Export moved to its own building located at Ostrovskogo Square.

Major leasing deals in Q1 2015 included Gazprom taking up the whole Eightedges Business Centre with a total floor area of 20,100 sq m on Malookhtinskaya Embankment.

Permission has been granted for the construction of a Class A office complex at a site on Shcherbakov Pereulok in St. Petersburg's Central District. The floor area of the future office building will be about 10,000 sq m.

Demand

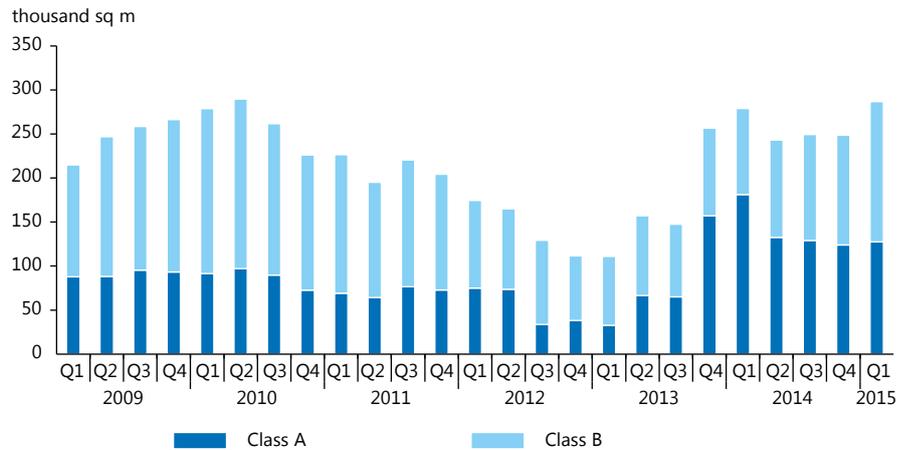
We see tenants changing their preferences and switching to high-quality offices with modern utility systems. The number of occupiers of high-quality office space has doubled over the past five years.

St. Petersburg's office vacancy rate reached 12.8% for high-quality offices as of the end of Q1 2015, rising by 1.5 p. p. from the end of last year.

In Q1 2015, the Class A vacancy rate continued its gradual downward trend started in 2014, with the Class B vacancy rate demonstrating slight growth, which had been witnessed since 2014 as well. The decline in the vacancy rate for Class A offices was caused by the move of Gazprom companies, which leased the most advanced premises in the city centre.

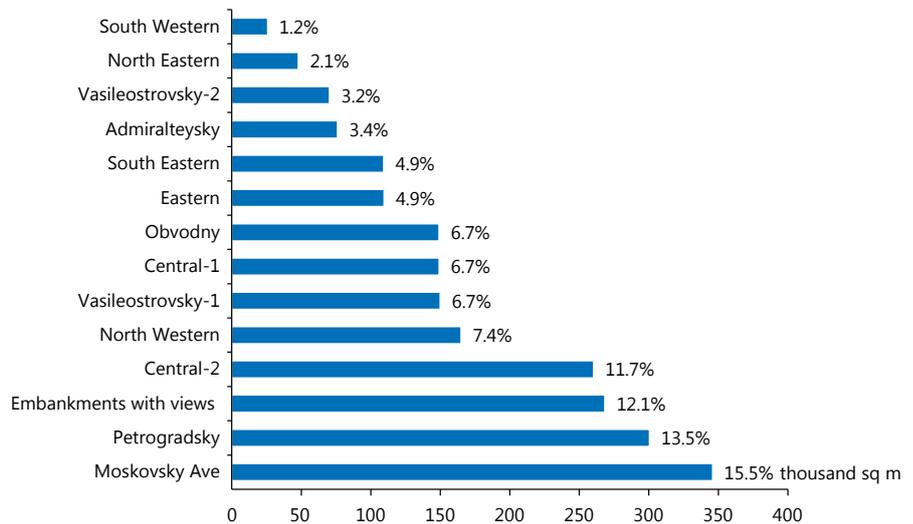
The Class A vacancy rate dropped to 16% in Q1 2015, decreasing by only 0.2 p. p. from the level observed in Q4 2014.

Supply of leasable office space, Q1 2009–Q1 2015



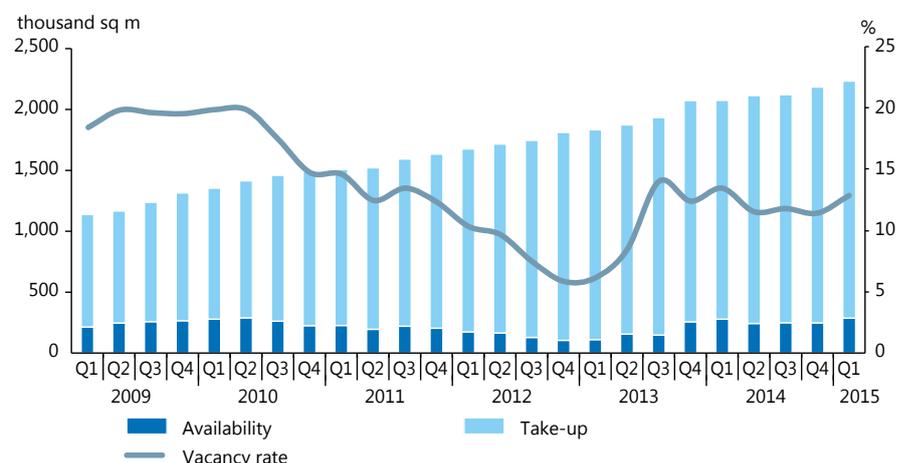
Source: Knight Frank St. Petersburg Research, 2015

Breakdown of gross leasable area by St. Petersburg business districts, Q1 2015



Source: Knight Frank St. Petersburg Research, 2015

Vacancy rate and GLA, Q1 2009–Q1 2015



Source: Knight Frank St. Petersburg Research, 2015

Office complexes delivered in Q1 2015

Name	Address	Class	Total floor space, thousand sq m	Office GLA, thousand sq m
Not for lease				
Zeppelin	6B Startovaya St	A	16	12.3
Gazprom Export office building	2 Ostrovskogo Square	A	15.5	11.7
Krummel House	12 Bolshaya Posadskaya St	B	6.4	3.5
Speculative developments				
Senator	1 Kropotkina St	A	9.9	6.7
Assambleya	12 Mayakovskogo St	A	2.4	1.8
SOVA	22 Marshala Tukhachevskogo St	B	12.3	9
Senator	60B Moskovsky Prospekt	B	6	4.5

Source: Knight Frank St. Petersburg Research, 2015

The increase in vacant Class B office space was due to some companies' need to cut lease costs, which forced them to move to offices of lower quality with lower rents in the past quarter. The Class B vacancy rate rose by 2.3 p. p. in Q1 2015, reaching 11.1%.

In Q1 2015, the take-up of high-quality office space, including office buildings that have been designed for specific companies and are used by them, totalled 47,700 sq m.

The delivery was almost the same as the take-up in the period. However, the vacancy rate is still high owing to low take-up levels in the previous periods and the large number of new offices being brought onto the market.

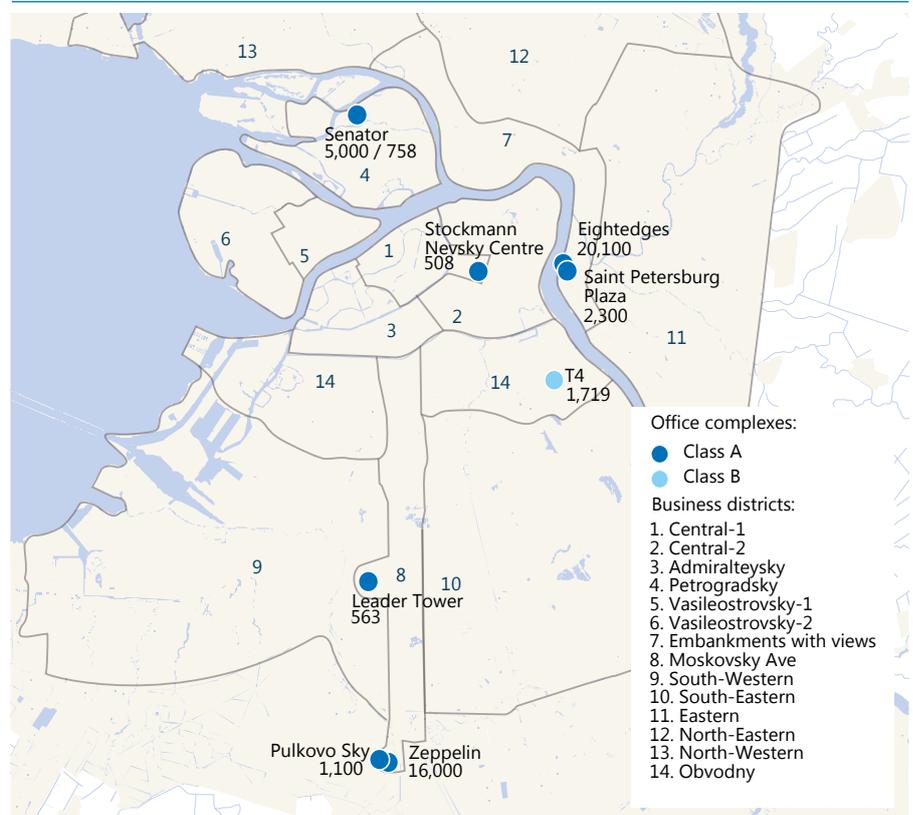
It should be noted that Class A properties accounted for 94% of the take-up, or 44,600 sq m, which was mostly due to Gazprom companies' large deals that made up 78% of the quarterly take-up.

Commercial terms

Q1 2015 saw a decline in face rents for St. Petersburg's high-quality office buildings. Landlords sought to reach a compromise over commercial terms with potential tenants, which brought the average rents very close to the tenants' expectations. Developers and owners are offering potential occupiers discounts, rent-free periods, refurbishment and other incentives.

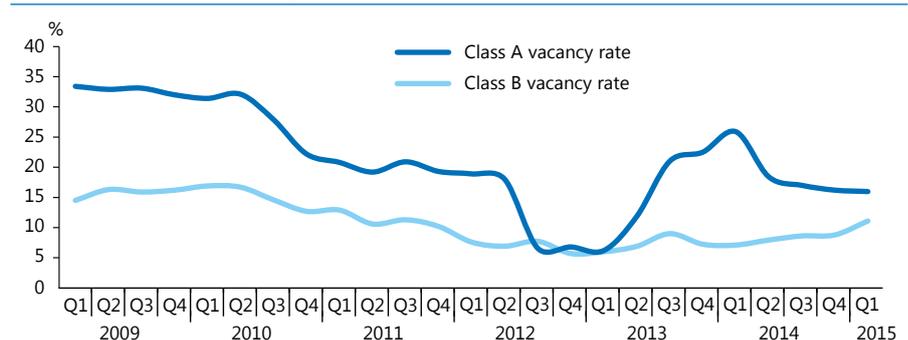
As of the end of Q1 2015, the weighted average face rent was 1,490 rub/sq m/month for Class A offices, including VAT and operating expenses, which is 8% lower than in Q4 2014. At the same time, the growing vacancy rate in the Class A office lease market forced landlords who had been facing problems with take-up to reduce their asking rents. The reduction exceeded 20% in some cases.

Major deals completed in Q1 2015 (over 500 sq m)



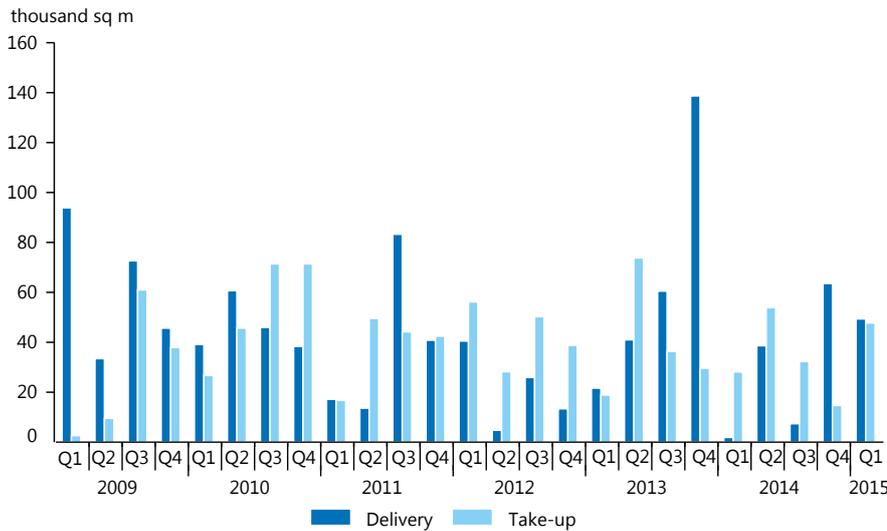
Source: Knight Frank St. Petersburg Research, 2015

Class A and Class B vacancy rate, Q1 2009–Q1 2015



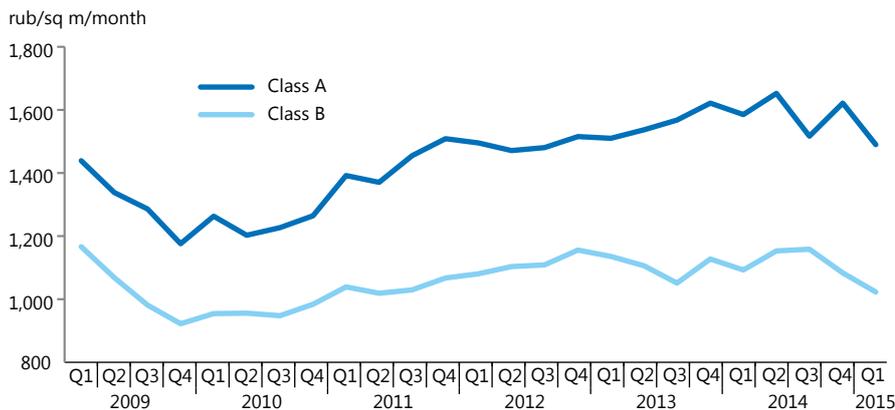
Source: Knight Frank St. Petersburg Research, 2015

Delivery and take-up of high-quality office space, Q1 2009–Q1 2015



Source: Knight Frank St. Petersburg Research, 2015

Class A and Class B office rents, Q1 2009–Q1 2015, rub/sq m/month (including VAT and OPEX)



Source: Knight Frank St. Petersburg Research, 2015

% change in Class A and Class B office space rents versus the previous quarter, Q1 2009–Q1 2015



Source: Knight Frank St. Petersburg Research, 2015

As for the weighted average face rent for Class B offices, it was 1,023 rub/sq m/month (including VAT and OPEX) as of the end of the quarter, which represented a 6% decrease from Q4 2014. The decline was caused by an upsurge in the supply of office space located far from the city's business centre. Some of new Class B offices are renovated Soviet-era administrative buildings with asking rents below the market average.

Forecast

There is about 260,000 sq m of office space due for completion in 2015, including buildings designed to suit companies' own needs. However, in view of construction timeframes being extended, we expect the supply to rise by no more than 190,000–200,000 sq m.

We may see further reduction in rents at properties experiencing difficulties with take-up, which may lead to a higher vacancy rate across the market. Landlords of taken up office buildings will continue offering various incentives to retain tenants, which may slightly reduce the average rent as well.

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