RESEARCH

MOSCOW

OFFICE MARKET OUTLOOK

Q1 2018

OCCUPIER TRENDS | INVESTMENT TRENDS | MARKET OUTLOOK

KEY FINDINGS

Russia's economy returned to growth in 2017 following two years of contraction.

Occupier activity was dominated by new leases and sales for owner occupation.

Average Class A rental rates fell moderately to RUB22,923/sq m while Class B increased to RUB14,074/sq m per annum.

Russian commercial investment volumes totalled US$4.3 billion in 2017, comparable to the previous year.

FIGURE 1

Office take-up, sq m

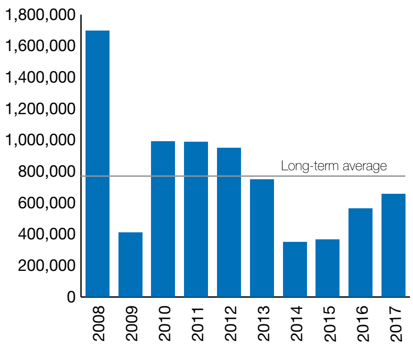
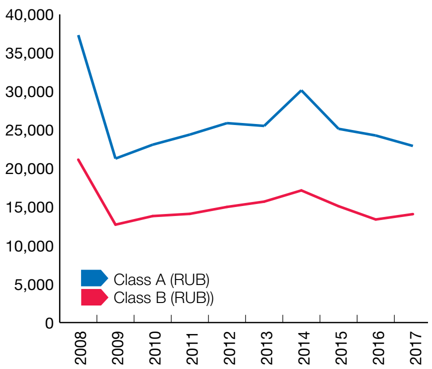


FIGURE 2

Average asking office rents

RUB per sq m per annum



Source: Knight Frank Research

OCCUPIER MARKET

Russia's economy returned to modest growth in 2017.

For the first time in three years, Russia's economy moved into growth territory, increasing by 1.7% in 2017. Other economic indicators have been trending in an encouraging direction. Inflation is down to 2.2% – well below the 4% target. Improvements in business and consumer sentiment are likely to reinforce economic growth.

Occupier activity in 2017 showed marked improvement on previous years, bolstered by strong lettings activity in Q4. Take-up reached 657,000 sq m in 2017 (Figure 1), with 45% of the volume transacting in the final quarter. Occupier activity was dominated by new leases and sales (70% of the transactional volume) as occupiers took advantage of favourable market conditions and lower rents. The area surrounding the Third Transport Ring was one of the most sought-after areas due to its good accessibility; supported by the recent completion of the Central Circle line, and the availability of high quality office stock. Office centres outside of the Moscow Ring Road, in contrast, were in low demand.

Overall, the market is showing signs of stabilisation, with the vacancy rate having declined against the 15-year low delivery volume to 13.0%. There are, however, marked divergences across the submarkets. The districts located between the Garden Ring and Third Transport Ring are characterised by a shortage of supply, in contrast to offices in remote business locations, which remain vacant.

There was a slow start to development activity in the first half of the year, but construction activity regained momentum in the second half of the year, with many projects completing. In total, just over 400,000 sq m of office space was delivered to the market. This year will see a similar volume of completions (450,000 sq m) across a range of schemes, including Park Huaming, Park of Legends, Bolshevik (phase II) and Empire II. However, the completion dates of some of these projects may be delayed to 2019.

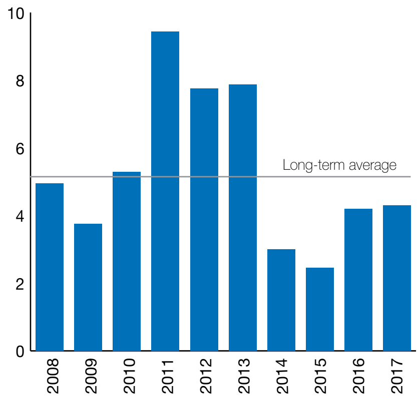
Commercial lease terms are changing on the back of improving market conditions. Incentives have been falling and the duration of lease terms is likely to increase in 2018, especially for properties that are in high demand. The Russian Ruble is still the dominant currency on lease agreements and as it strengthens against the dollar, it will slowly phase out the nomination of agreements in dollars. The average asking rents for Class A have fallen moderately by 5.6% to 22,923 RUB/sq m/year, in contrast to Class B which saw an increase of 5.2% over the year to 14,074 RUB/sq m/year (Figure 2).

Key office leasing transactions in 2017

Building	Occupier	Building Class	Size (sq m)
Poklonka Place	Auction LLC	B+	38,317
Bolshevik	VimpelCom	A	17,004
VTB Arena Park	Transmashholding	A	14,400
Novospasskiy Dvor	Technoserv	B+	14,000
BC on B. Yakimanka str, 42	Glavgosekspertiza Russia	B+	13,600
Comcity	Tele2	A	13,053

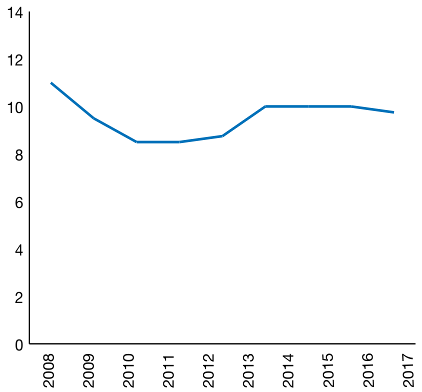
Source: Knight Frank Research

FIGURE 3
Russia commercial* investment volumes US$ billion



Source: Knight Frank Research
*Office, retail, logistics and hotel

FIGURE 4
Prime office yields
%



Source: Knight Frank Research


The City of Capitals in the Moscow International Business Center

INVESTMENT MARKET

In parallel with the occupier market, the Russian investment market continued its recovery after years of muted activity. This was against the backdrop of improving key macroeconomic indicators and a strengthening national currency.

In 2017, US$4.3 billion was invested into Russia's commercial real estate, comparable to 2016 volumes (Figure 3). Despite raising concerns about the banking sector, a number of large deals concluded at the end of 2017, including the Immofinanz Shopping Centre portfolio. Overall, the retail sector dominated at 44% of the total transaction volume, while the office sector accounted for 38% of the total investment volume.

Cross-border activity remained subdued in 2017, with foreign investment accounting for 13% of the total transaction volume. There were however new foreign investors in the Russian market, while foreign companies and funds already present in the market continued their development. Fosun Group became the first Chinese investor to acquire Russian commercial real estate since 2010, acquiring the Vozdvizhenka Centre, which was the largest office transaction of the year.

Prime yields hardened to 9.75% in 2017 (Figure 4). Further interest rate cuts will continue to lower the cost of lending, leading to further yield compression in 2018.

Key office investment transactions in 2017

Building	Vendor	Purchaser	Price (USD million)
Vozdvizhenka Centre	Dmitry Rybolovlev	Fosun Group, Avica Management	170
Svyatogor	Megakom LLC	VTB, Alfa Bank	70
Solutions	n/a	Ingrad	68
Sretenka 18	Russkiy Karavay LLC	Platforma	52
Izvestia	Izvestia JSC	Tashir	30

Source: Knight Frank Research

KNIGHT FRANK VIEW

Moscow's office market is entering a phase of growth. The occupier market is strengthening against the backdrop of improving economic conditions.

Rents appear to have bottomed out. During 2018, we expect rental rates to increase in the order of 3-5%, particularly in highly sought-after areas due to supply shortages. Construction activity will also increase, but will be subject to ongoing stable demand.

The investment market will continue to recover in 2018. As inflationary risks have eased, further interest rate cuts may be on the cards for this year. Commercial investment volumes are expected to be up on 2017, with continued activity from foreign investors.

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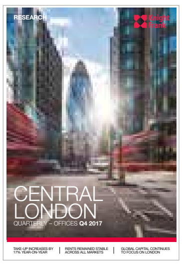

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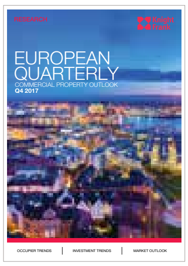

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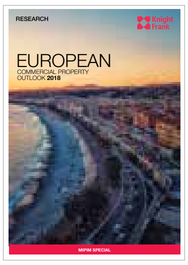

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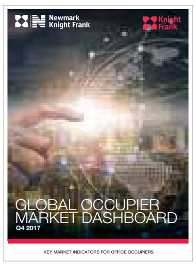

Global Occupier Dashboard - Q4 2017

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