OVERVIEW

H1 2011
OFFICE REAL ESTATE MARKET
Moscow

Knight Frank

MAIN POINTS

- The delivery of new space in the first half of 2011 was at its lowest level in seven years: growth in total supply of Class A and B office space in Moscow was just 3% (about 330,000 sq m).
- There was steady growth of demand in both segments during H1 2011. Overall demand grew by 20% compared with the first half of 2010 (y-o-y) to a level of 430,000 sq m. It was almost equally divided between Classes A and B, while in 2010 nearly 70% of leased and purchased space was in Class A.
- Shrinkage of new supply and increasing demand is forcing down the vacancy rate. This state of affairs will endure in coming years despite increase of lending available for office projects. New Class A projects, that may be announced soon, will come onto the market no sooner than 2014 and the vacancy rate will continue to decline until that time.
- Rental rates for Class A and B space have been rising briskly for the last 12 months. Growth in the first half of 2011 was 7% in Class A and 4.5% in Class B.

OFFICE REAL ESTATE MARKET

Key indicators	Class A	Class B+	Class B-
Total stock, million sq m		11.52	
including, million sq m	2.19	6.31	3.02
Change from the end of 2010, %	+6%	+3%	+2%
Commissioned in H1 2011, sq m		329,400	
including, million sq m	125,100	159,400	44,900
Vacancy rate, %	14.5	19.2	
Change from the end of 2010, p.p	-3 p.p	-1 p.p.	
Base rental rates**, $ per sq m per annum	600-1,100 (950-1,300**)	400-600	260-400
Change from the end of 2010, %	+7%	+3%	
OPEX, $ per sq m per annum	110-210	80 - 120	50-95

*Excluding OPEX and VAT (18%)
**Average range of requested rental rates for premises with a premium location
Source: Knight Frank Research, 2011

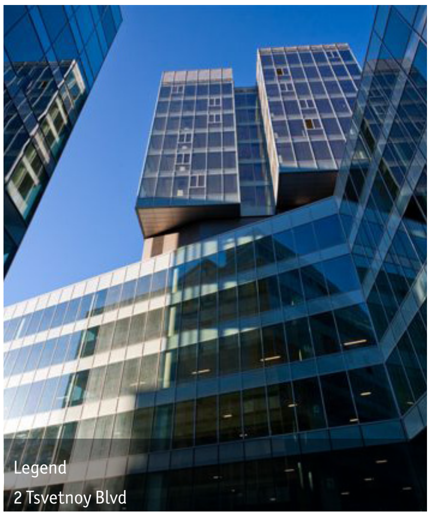
Kirill Starodubtsev
Managing Partner, Knight Frank

«In the first half of 2011 we saw the continued recovery of the real estate market. Demand for Class A and B office space shows the steady growth, the amount of leased and purchased office space have closed to the pre-crisis meanings. However, the decline in new supply becoming more noticeable - reducing of the construction volumes in 2009-2010 concurred the change of political course in the capital. A ban of construction in the city centre, the review of investment contracts and other initiatives had a significant impact on the market of office space. Already there are signs of shortage of quality projects in Central business district, causing by an accelerated growth in rents for premium space».

Supply

Total supply of Class A and B rental space in Moscow in the first half 2011 was 11.5 million sq m, representing an increase of 3% from the end of 2010. This is the lowest growth rate in the last seven years (the rate has traditionally been 5-10%) that causes by the fall of construction volumes during the crisis as well as the changes of political forces in Moscow. Review and cancellation of investment contracts, change of lease periods for development sites, a ban on construction inside the Third Transport Ring, recently announced changes to the city's geographical boundaries, and possible transfer of some administrative structures outside the city. All of these measures are intended to improve Moscow's infrastructure in the long term prospective, but they have inevitably led to revision of plans by developers, so that progress of commercial real estate projects has slowed down.

Increase of lending for commercial property development (about $700 million in H1 2011 compared with $780 million in the whole of 2010) and improvement of debt financing terms make it probable that new projects will be announced towards the end of 2011 and in the first half of 2012. These are likely to be decentralised projects, with the delivery dates in 2014-2015.



Legend
2 Tsvetnoy Blvd

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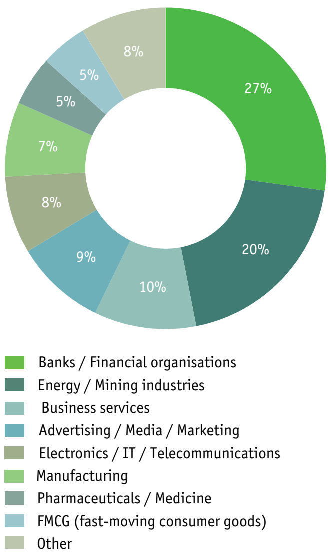
Demand

About 210,000 sq m of Class A office space was leased and purchased in H1 2011, representing an increase of 15% y-o-y. The maximum Class A take-up level of 1.2 million sq m was recorded in 2007, when the number of lease agreements for quality office space in Moscow was also at an all-time high. Lease agreements are usually concluded for a period of five years, so a number tenants need to make decision in 2011 whether to renew current contracts or to expand their space or move to new premises. This is one of the reasons for current high levels of demand for Class A premises. And accelerated growth of rental rates has spurred tenants that make new agreements this year to select premium space with good location while commercial terms for such buildings are still affordable. Unprecedentedly low rates of new supply reduced the vacancy rate in Class A business centres from 17.4% at the end of 2010 to 14.5% by mid-2011.

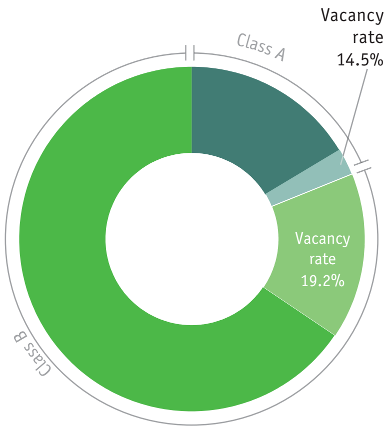
Lease and sale of Class B office space in H1 2011 was about 300,000 sq m, which is nearly a third more than in the first half of 2010. Take-up of Class B space exceeded new supply for the first time since the start of 2010. Growth of demand in Class B was steady, in contrast with

Demand for office space in H1 2011 was diversified



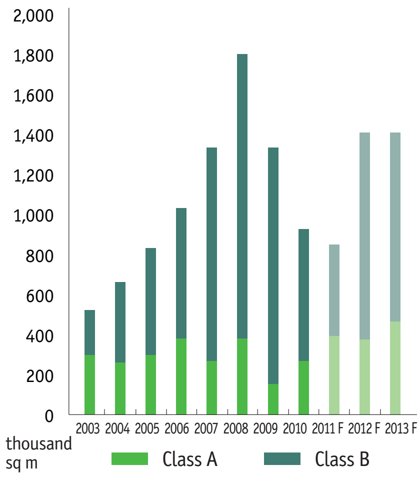
Source: Knight Frank Research, 2011

Class B supply is 4.3 times greater than Class A supply. Vacant spaces is six times higher in Class B



Source: Knight Frank Research, 2011

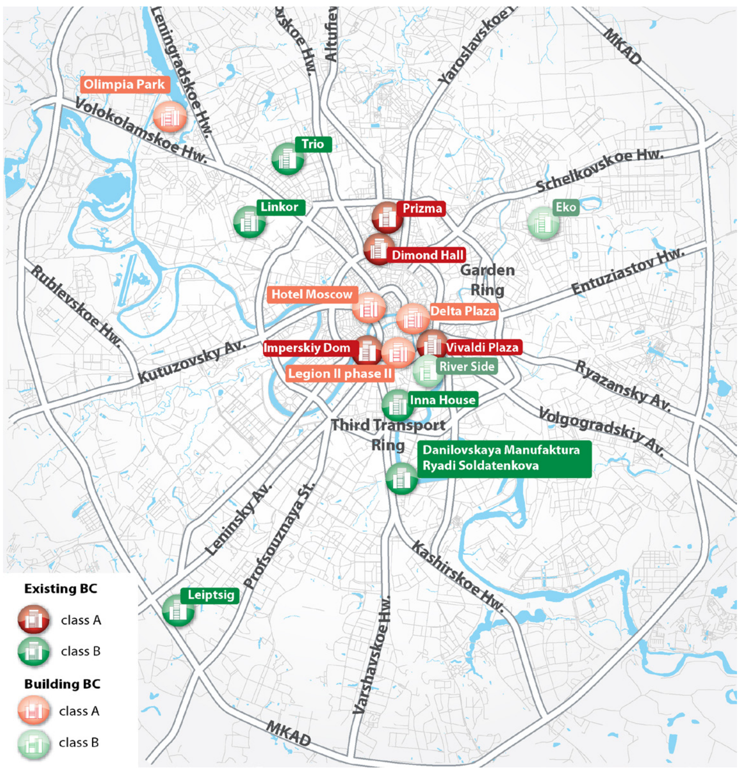
The delivery of new office projects in 2011 will reach the minimum points since 2005



**Forecast is based on the plans of developers of the projects and can be changed*

Source: Knight Frank Research, 2011

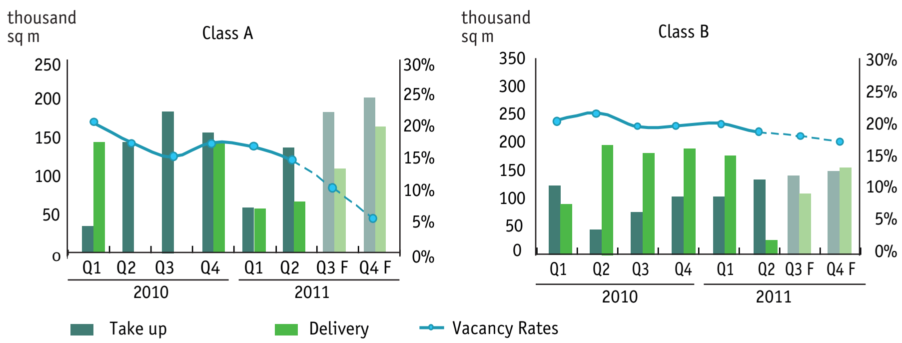
The key projects delivered* in H1 2011 and projects expected to be commissioned by the end of the year



*Completed buildings, which have received the statement of conformity
Source: Knight Frank Research, 2011

the situation in Class A where transactions have been larger and growth rates have fluctuated from quarter to quarter. Average transaction size in Class B was about 2,000 sq m in H1 2011, which is significantly lower than 3,400 sq m in Class A. Deals in excess of 5,000 sq m are only half as frequent in Class B compared with Class A. Generally, post-crisis recovery of demand for offices in the lower Class has been slower than for premium offices, but Class B demand is now quickening. Large availability of space is one reason for relative sluggishness of Class B demand: there is nearly six times more vacant space in Class B than in Class A.

Increasing demand in Classes A and B against the background of low delivery, so vacancy rates are declining



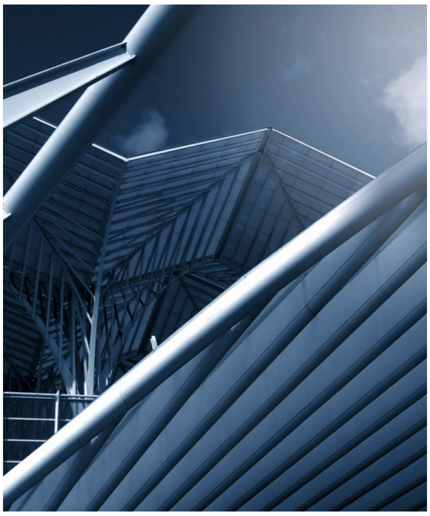
Source: Knight Frank Research, 2011

Key transactions in H1 2011

№	Company	Area, sq m	Address	Property
Lease				
1	Grinatom	13,500	8 Paveletskaya Emb	AFI na Paveletskoy
2	Morton	11,520	8 Preobrazhenskaya Sq	Preo 8
3	Group M*	10,800	2 Tsvetnoy Blvd	Legend
4	OEK	10,770	14 Serebryakova Passage	Silver Stone
5	Renaissance Credit*	10,680	Building 1A, 12 Dvintsev St	Dvintsev
			Bld 1, 8 Presnenskaya Emb	Capital City
6	Schneider Electric	8,680	Bld 1, 12 Dvintsev St	Dvintsev
7	Credit Europe Bank*	7,620	12/16 Olimpiisky Ave	Diamond Hall
8	TNT Express	6,800	Bld 2, 3 Passage №607	Novaya Riga
9	Russian Development Bank	6,100	79 Sadovnicheskaya St	Progress
10	Pfizer	5,800	10 Presnenskaya Emb	Naberezhnaya Tower
11	Transaero	5,500	13 Zubovsky Blvd	Park Kultury House
Purchase by end-user				
1	Confidential	28,120	1 Vasilisy Kozhinoy St	Park Pobedy
2	VTB	16,000**	Bld 1, 13 Krasnopresnenskaya Emb	Federation, West Tower
Investment purchases				
1	Promsvyaznedvizhimost	37,000	1 Arbat St	Alfa Arbat Centre
2	Aliv-M	12,200	Bld 2, 50A/8 Zemlyanoy Val St	Sadko
3	VTB Capital TPG Capital	share in the project	5 Lesnaya St 29 Lesnaya St	White Square White Gardens

*Knight Frank is consultant of the deal

** Approximate area



Commercial terms

Growth of demand and low levels of new supply have led to higher rents in both segments. Rental rates have risen by 7% in Class A and 3% in Class B since the beginning of the year. As before, growth has been driven by premium projects: rental rates for Class A property with central location have risen by 15-20%.

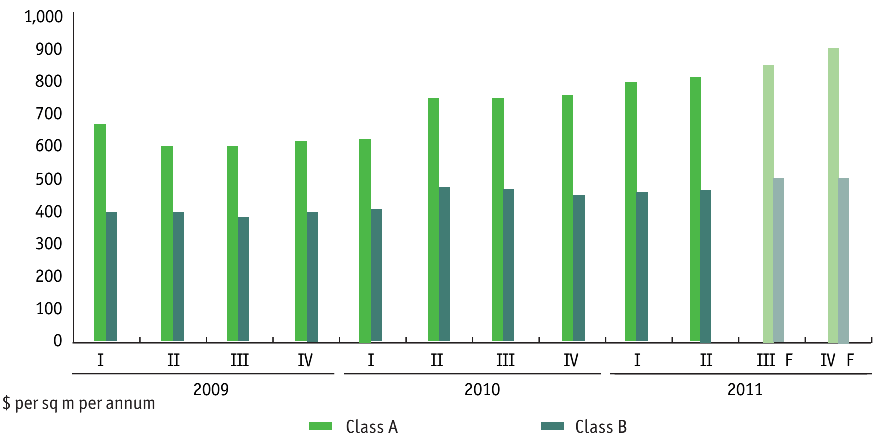
The present market situation will cause further growth of rates. We expect rents for premium Class A properties to rise by 20-30% in full-year 2011. Rates for property, which is remote from the city centre, may rise by 10%.

Forecast

The market has entered a confident growth phase in the last 12 months: there has been rapid increase of take-up and rental rates since the start of 2010. In Class A office segment this process occurs more rapidly as tenants hurry to make new agreements while commercial terms are still relatively favourable. Class A supply shortage is probable coming 12-18 months, and a part of demand will shift to Class B offices. We expect 15-20% annual growth of demand in the coming three years.

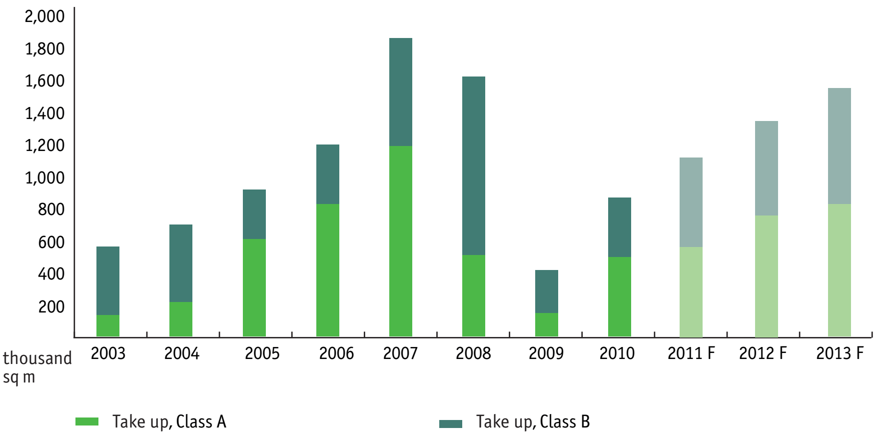
Demand growth is driven by external political and economic factors: recent initiatives by city authorities to limit construction inside the Third Transport Ring and overall uncertainty about prospects for commercial real estate construction have led to reduction of new supply. Under these conditions, availability is reducing. At the same time, research by Kelly Services and Antal Russia shows that tenant companies are planning to hire more staff (staff increases of up to 40% are expected in 2011 alone), so that companies will be forced to expand their office space.

Rental rates are growing steadily



Source: Knight Frank Research, 2011

Demand is likely to grow by 15-20% per annum in the next few years, due to administrative events in Moscow and growth in staff numbers of tenant companies



Source: Knight Frank Research, 2011

GLOSSARY
(THE KEY DEFINITIONS)

Term	Definition
Base Rental Rate	The rental rate amount excluding operational expenses and VAT.
Business Park	A complex of buildings with low-density development and large ground parking. Its usual location is outside the city center with good accessibility to main highways.
Business-centre	A property with high-quality office premises, wide pool of tenants and centralized management system.
Commissioning	The object is commissioned after the state commission and the receipt of Operation Permit.
Developer	A company that conducts the construction of a real estate project, provides financing or attracts financial resources. Also the company provides further implementation of space developed (sale, lease).
Free-rent period	A time period that is free of rental paymentss
Lease Agreement	An agreement, which is concluded between a tenant and a landlord and gives a right to the tenant to temporarily possess or use the property for the certain charge called a rental fee.
LOI (Letter of Intention)	Preliminary agreement between a landlord and a tenant that confirms the intention of the parties to conclude a lease agreement. It contains preliminary terms that will be included to the lease agreement.
Loss factor	$(1 - \frac{useable\_area}{rentable\_area}) * 100\%$
Multifunctional complex	A property with three or more real estate components of different functions.
OPEX (Operational Expenses)	Money expenditures allocated for the operation and maintenance of the property. They usually include property taxes, insurance payments, management and maintenance costs of property, utilities.
Pre-lease agreement	A lease agreement that is concluded during the construction phase of the building.
Rentable Area	Area available for the exclusive use of the tenant, for which the tenant will pay rent. Includes common areas such as lobbies, restrooms and hallways.
Rental Rate	The amount of money paid by the tenant for the rental of office space (per sq m per annum).
Sublease	A lease in which the original tenant (lessee) sublets all or part of its premises to another tenant (subtenant) while still retaining a leasehold interest in the property.
Take-up	The amount of units occupied during a particular time period in a given market.
Total Area	Total area of a building measured on the outer sides of exterior walls.
Total Stock	All occupied and vacant Class A, B+ and B- office space for a specific time period.
Useable Area	It is the tenant’s rentable area less certain common areas shared by all tenants of the office building (such as corridors, storage facilities and bathrooms). It is applied for the location of the workplaces, equipment and furniture. The area is measured on the interior sides of building walls including the measurement of structural columns and architectural projections. It doesn’t include common areas.
Vacancy	The number of units or space that is vacant and available for occupancy at a particular time period within a given market (usually expressed as a vacancy rate).
Vacancy rate	The percentage of total office stock that is vacant and available for occupancy at a particular time period within a given market. It is calculated by dividing vacant space by total space.

OVERVIEW

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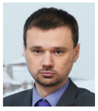

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Together with Newmark Company, Knight Frank's strategic partner, the company encompasses 209 offices in 47 countries across six continents.

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Knight Frank's employees are professional consultants in various fields connected with real estate, such as rent and sale of properties, selection of properties, attraction of investments, consulting, valuation, market research, marketing and project promotion, property and asset management.

We offer the full range of consulting services not only for developers and owners, but also for real estate users; both legal entities and individuals. Now, the company's staff consists of more than 330 employees.

This and other Knight Frank overviews can be found on the company website www.knightfrank.ru.

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