OVERVIEW

2010

OFFICE REAL ESTATE MARKET

Moscow

Knight Frank

EXECUTIVE SUMMARY

- Growth in supply of Class A and Class B offices is still slow, mainly due to difficultly obtaining financing for new projects and cautious attitude of banks to property lending. Reduction of supply is particularly noticeable for high-quality office premises inside the Garden Ring, and shortages of the office premises in this segment are very likely in the next 2-3 years.
- Demand for office space is growing, and about half of space is bought outright. Transaction volumes in the Class A and B office segment grew by 1.4 times in 2010.
- Rental rates have been growing since the end of 2009 when demand recovered, and this trend has been consolidated in 2010 in a situation where take-up has drawn level with new commissioning and then overtaken it by about 5%. Class A rental rates have grown by 20% and the growth in Class B has been about 10%.
- We expect to see more intensive lease and purchase activity on the Moscow office market in 2011, with consolidation of demand and rental rates at the levels, which have been achieved. Assuming further macroeconomic stabilization there is every probability that business activity will expand in the coming 2-3 years.

OFFICE REAL ESTATE MARKET

Konstantin Losyukov
Head of Corporate Client Group,
Office Real Estate Department

"The office property market has been growing for the last 18 months. We believe that it will continue growing in 2011-2012. Although the crisis has been left behind, its negative effects will influence the market in the medium term. Most likely, limited supply in the Class A office segment is failing to keep pace with rapid demand growth. Our recommendation to companies, which plan to expand their office space or move to higher-class premises, is therefore to take action in the near future, in order to avoid further increase in rental rates".

Key indicators	Class A	Class B+	Class B-
Total stock, million sq m		11.2	
including million sq m	2.07	6.15	2.97
Commissioned in 2010, sq m		952,000	
including sq m	290,400	511,300	150,100
Vacancy rates, %	17.4	20.1	
Base rental rates*, $ per sq m per annum	500-1,100 (900-1,200**)	350-550	200-395
OPEX, $ per sq m per annum	80-210	80-120	50-80

* Excluding operating expenses and VAT (18%)
** Average range of asking rents for premises with premium locations
Source: Knight Frank Research, 2011

Supply

Commissioning of new Class A and B offices in Moscow totalled to 952,000 sq m in 2010, which was 30% less than in the previous year and barely half of the level in 2008.

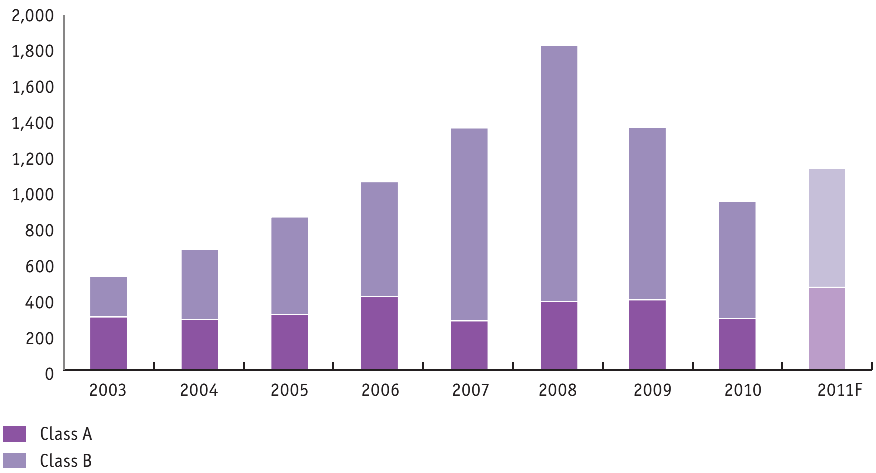
For two consecutive quarters (Q2 and Q3) there was not a single new Class A office centre delivered to the market. However, Class A premises were about 30% of supply during the whole year, which is comparable with the Class A share in 2008 and 2009.

Few new projects have been announced. Policy of the new city authorities has limited construction of office premises inside the Third Transport Ring, so that further reduction of new commissioning and rapid decline of the vacancy rate should be expected in the Central Business District.

There is still a shortage of demand for the office buildings under construction, and newly delivered buildings are usually at least half empty, failing to generate expected income for the developer. Owners of developments, which are ready for

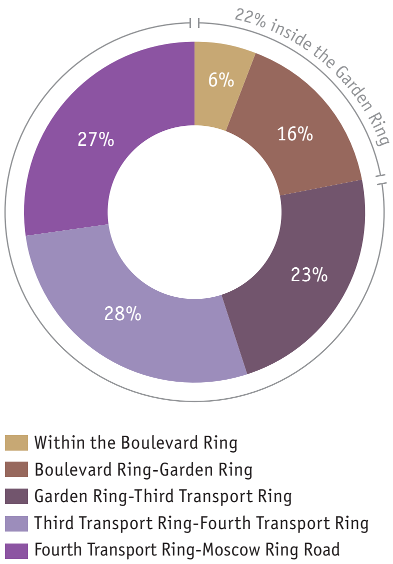
Growth rates of Class A and B office space declined in 2010 and were comparable to 2005-2006

thousand sq m

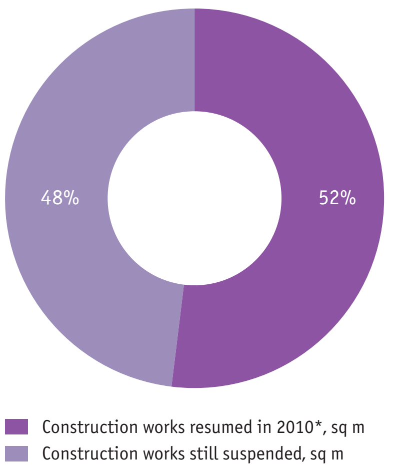


Source: Knight Frank Research, 2011

Only 22% of premises commissioned in 2010 are located in the Central Business District



Construction work has resumed at about half of projects, which had been suspended, but change of status looks unlikely for the other half of projects



* The figure shows the only projects, where construction works were officially suspended

Source: Knight Frank Research, 2011

Main projects commissioned* in 2010

Name	Location	Total office space, sq m
Class A		
Domnikov	30 Akademika Sakharova Ave	132,600
Western Gate	22 Belovezhskaya St	60,500
Preo 8	8 Preobrazhenskaya St	75,000
Office and retail centre	1 Arbatskaya Sq	
Legend of Tsvetnoy	2 Tsvetnoy Blvd	30,400
Riverside Towers V	52 bld. 7 Kosmodamianskaya Emb	20,800
Marr Plaza	13 Sergeya Makeeva St	21,900
Summit	22 Tverskaya St	18,570
Class B+		
Nagatino iLand	18 Andropova Ave	163,500
Sky Point	28V Mezhdunarodnoe Hwy	46,350
Moscow Silk III	12 B. Savvinskiy	33,720
W Plaza	1 Varshavskoe Hwy	31,390
Danilovskaya Manufacture, Knop building	9 Novodanilovskaya Emb	26,000
	9 Zavoda Serp i Molot Passage	25,000
South Park	141B-143C Varshavskoe Hwy	22,920
Yakovoapostolsky	14 bld. 1 Yakovoapostolsky lane	10,460
Well House	111 bld. 2 Leninsky Ave	10,000
Nouvelle Complex	5 Stary Tolmachevsky lane	9,815
Class B-		
Perovo BC	9 bld. 1-9 Perova Polya 1st Passage	19,500
East Gate	100 bld. 7, 20 Schelkovskoe Hwy	12,500

* Completed projects, which have been accepted by the State Commissioning Committee and received an ownership certificate

Source: Knight Frank Research, 2011

commissioning, are in no hurry to complete document formalities, because since then the property becomes subject to tax liabilities, which cannot be met from rent income.

During the acute stage of the crisis several dozen Moscow office projects with overall space of 3.3 million sq m were suspended. Growth of business activity, recovery of demand and improvement of the financial environment enabled several developers to resume construction work in 2010. At least 1.8 million sq m of office space (15 projects) is being resumed. But more than half of these projects are still in their initial stages and it is hard to predict their delivery to the market in 2-3 years from now.

The construction cycle for office projects in Moscow is 4-5 years from the time when building permission is obtained, so in the next 3 years it is expected the only commissioning of projects, which have already been announced, and rates of growth of office supply are likely to remain unchanged. According to our estimates about 1.5 million sq m of Class A offices are scheduled for commissioning during 2011-2013. Only the fifth part of this volume is located in the Central Business District, representing just 270,000 sq m, which is comparable with Class A transaction volume in Q4 2010. A shortage of high-class premises in central Moscow therefore looks certain. The problem is less acute for Class B premises because total supply in the segment is nearly three times greater than for Class A and because a greater volume of new projects have been announced in Class B (mainly reconstruction of former production facilities).

Demand

There was an increase in demand for high-class office premises (Classes A and B) during 2010, and transaction volumes rose by 1.5 times in comparison with 2009. Greater lease and purchase activity not only reflects the recovery in the economy, partly it was a one-off effect of postponed demand. The crisis made companies reduce their costs, either by postponing plans to change and expand their office space or by leasing cheaper premises. Stabilization in the economy has encouraged companies to resume their search for better premises.

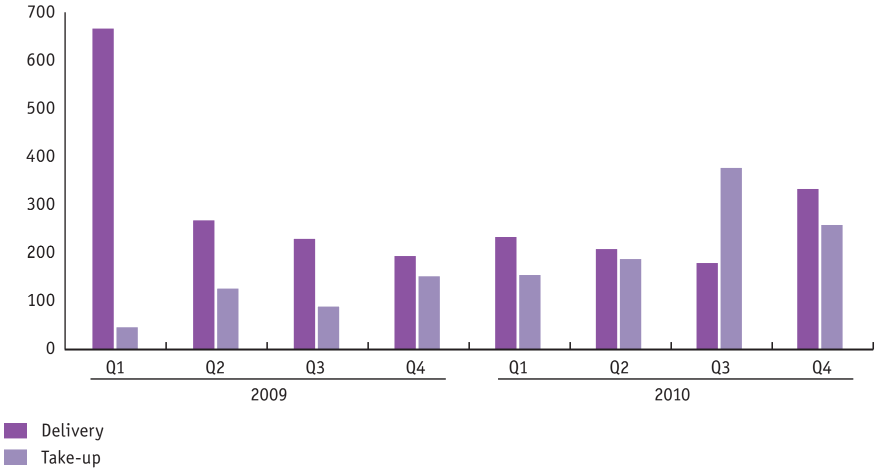
Most recently there has been a significant increase in property purchases. These transactions are not only for investment purposes: more than a third of the premises have been bought by companies for their own use.

At the start of 2010 there was an expectation that efforts by companies to reduce costs would make Class B premises more popular. However, reduction of demand in the Class A segment and attainment of an attractive price-to-quality ratio in the segment led to higher demand for Class A premises.

The vacancy rate stopped growing in 2010 and settled at a level of 18% across the market. However, the rate varies depending on distance from the centre of Moscow. It's worth noting that delivery of new business centres to the market impacts a lot on the amount of vacant space in each district of the city, since the new premises were oriented to pre-crisis take-up levels and newly built properties take longer to fill.

An increase in business activity has been evident since the end of 2009 and demand has been increasing steadily since the start of 2010

thousand sq m



Source: Knight Frank Research, 2011

About 50% of total office take-up in 2010 consisted of purchases by end-users

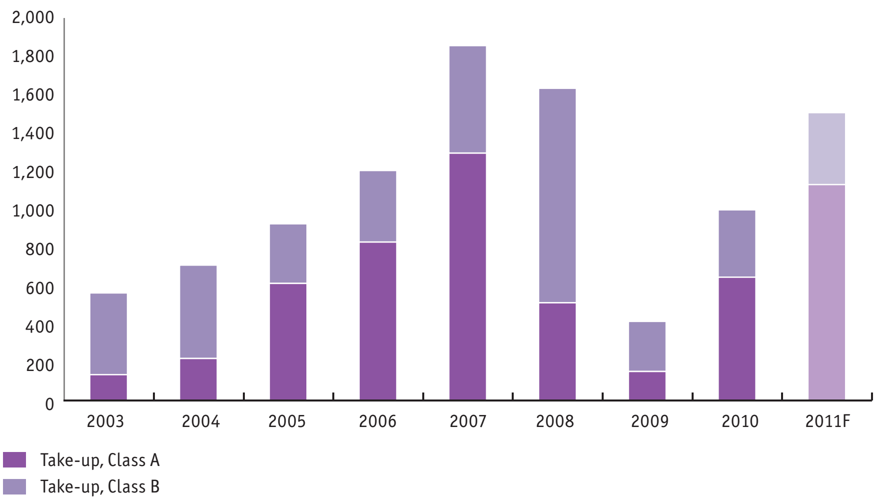
Source: Knight Frank Research, 2011

Renegotiation of commercial terms no longer represents a large share of overall transactions

Source: Knight Frank Research, 2011

Distribution of demand by Classes. Since 2010 there has been a positive demand trend and the share of high quality space in all transactions has been restored

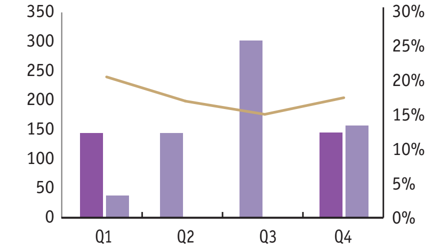
thousand sq m



Source: Knight Frank Research, 2011

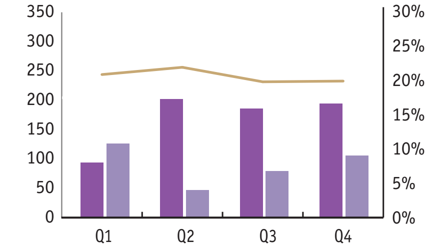
The vacancy rate in Class A declined thanks to rapid take-up, although it rose slightly in Q4 due to delivery of several large projects in that quarter

thousand sq m



There was almost no change in the Class B vacancy rate, since growth of demand was matched by high rates of new commissioning

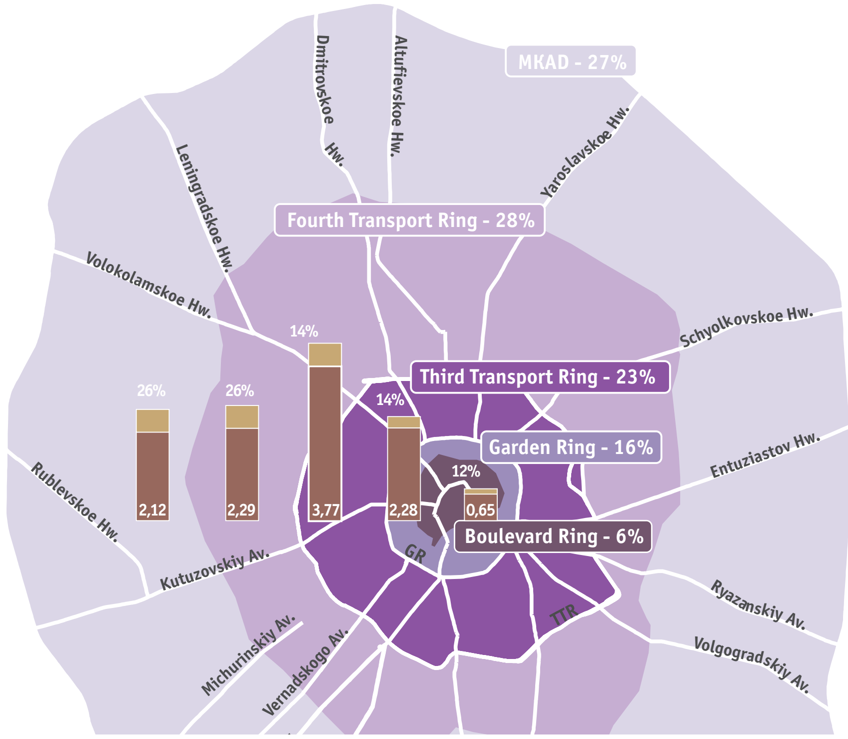
thousand sq m



Delivery
Take up
Vacancy rate

Source: Knight Frank Research, 2011

Vacancy rates in Classes A and B were 17.5% and 19%, respectively, at the end of 2010. But it should be noted that vacant space in Class A was about 350,000 sq m in absolute terms, which is about 5 times less than in Class B (1.73 million sq m)



Vacant space
Total supply, mln sq m
MKAD - 27% The share of new office space in the area related to the delivery in 2010

Source: Knight Frank Research, 2011

Key transactions in 2010. Lease

№	Company	Size, sq m	Address	Project name
1	TNK-BP	37,700	3 Begovaya St	NordStar Tower
2	Sportmaster / Ostin	16,700	4 Kochnovsky Passage	Aviator
3	E4 Group	10,435	12 Krasnopresnenskaya Emb	World Trade Centre
4	Sanofi Aventis*	8,900	22 Tverskaya St	Summit
5	Danone	6,600	Novorizhskoye Hwy (7 km from MKAD)	Riga Land
6	IT	6,515	Bld 6, 19 Leninskaya Sloboda St	Omega Plaza
7	Samsung Electronics	5,880	10 Vozdvizhenka St	Voentorg
8	MoskommertsBank	5,575	3 Begovaya St	NordStar Tower
9	Otkrytiye	5,555	12/1 Yakovoapostolsky lane	Yakovoapostolsky
10	Eldorado	5,275	14 Smolnaya St	Smolny

* Knight Frank is a consultant of the transaction
Source: Knight Frank Research, 2011

Key transactions in 2010. Purchase**

№	Company	Size, sq m	Address	Project name
1	RWM Capital	84,550	34 Mashi Poryvaevoy St	Domnikov
2	Confidential*	60,410	21 Belovezhskaya St	Western gate
3	Siemens	27,995	13 B. Tatarskaya St	Legion II
4	Bank Otkrytiye	25,040	8/4 Kozhevnicheskaya St	Vivaldi Plaza
5	Sogaz	19,240	10 Akademika Sakharova Ave	Wave
6	RusHydro	14,700	7/9 Malaya Dmitrovka St	Pallau MD
7	East Group*	14,510	5 Stary Tolmachevsky lane	Nouvelle Complex
8	Finam*	7,435	Bld 2, 7 Nastasinsky lane	-
9	Lukoil	7,200	4, 5 Bld 1, 2 Ulansky lane	Ulansky

*Knight Frank is a consultant of the transaction
** Purchase of office property by the end-user
Source: Knight Frank Research, 2011

Commercial terms

Take-up of quality office premises exceeded delivery of new space by about 5% in 2010, which led to growth of rental rates. The imbalance between supply and demand caused unequal growth of rent levels between segments: rates for high-class premises grew by 20% in 2010, while growth for Class B premises was about 10%. Growth in the period from Q3 2009, when rates dropped to their lowest level, until the end of 2010 was 25% for Class A and 18% for Class B.

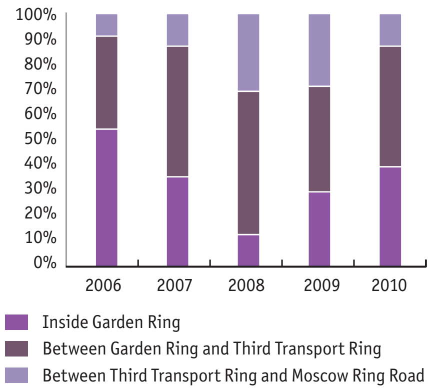
Forecast

We expect slow but consistent growth of demand for quality office premises in 2011 thanks to further recovery and growth of the Russian economy and also due to steady demand from tenants, who are currently occupying Class B- and C premises and want to relocate upwards.

The Russian market for quality office space is at an earlier development stage than European markets. Lease terms in Moscow are shorter (usually 5 years), quality of construction of office complexes increases year by year, and the class of some old and depreciated premises is declined. Companies are expanding their business and increasing their staff numbers to take advantage of growth of markets for their goods and services in Russia. As a result, when their leases expire, tenants are often keen to expand their office space and relocate to new premises, which better reflect their status.

We therefore expect steady growth of demand for quality office premises. In the context of reduced supply in the Class A segment, this will cause further increase of rental rates. Rents will also be driven by further high levels of investment activity in 2011. There is no reason to expect any serious changes on the market for Class B office property, and the current situation in that segment is likely to be maintained.

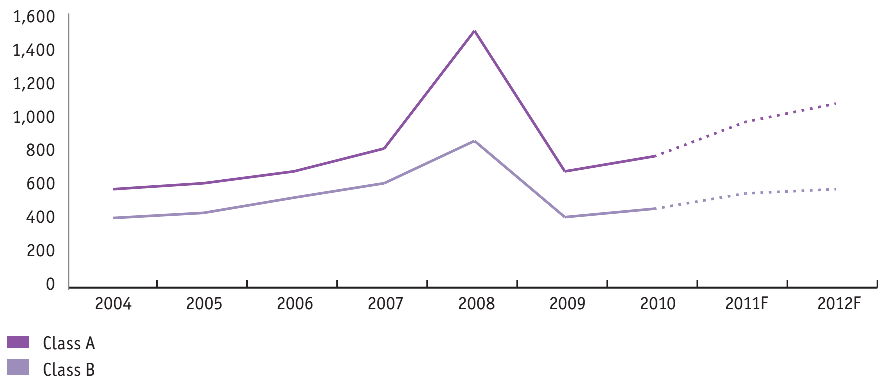
Further growth of demand for premises inside the Garden Ring during 2010 caused increase in the share of transactions in that part of the city from 30% to 40% of total transactions (by sq m)



Source: Knight Frank Research, 2011

There was consistent growth of rental rates for Class A and B offices during 2010

$ per sq m per annum



Source: Knight Frank Research, 2011

NOTES

OVERVIEW

Americas & Canada
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Canada
United States

Europe
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France
Monaco
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Ireland
Italy
Netherlands
Poland
Portugal
Romania
Russia
Spain
Switzerland
Ukraine
UK

Africa
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Kenya
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