The total of commissioned offices in 2020 amounted to only ***224.4 thousand sq. m***

The share of vacant space at the end of Q4 2020 reached ***11.7%*** *in Class A offices and* ***6.1%*** *in Class B offices*

Knight Frank

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OFFICE MARKET REPORT. MOSCOW

2020

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«The year 2020 in the Moscow office market was marked by a twofold drop in demand and supply input. Due to the high level of uncertainty in the market, office users preferred to stay within the framework of current projects, and developers preferred to postpone the commissioning of their buildings until 2021. Despite the impact of restrictive measures on the office segment, rental rates and prices have not changed significantly over the year. In 2021, demand is expected to recover and the volume of new space is expected to grow».

Key conclusions:

- The total of commissioned offices in 2020 amounted to only 224.4 thousand sq. m., which is 41% less YoY.
- The share of vacant space at the end of Q4 2020 reached 11.7% in Class A offices and 6.1% in Class B offices.
- Asked rental rates for Q4 2020 amounted to 25,528 rubles / sq. m. / year in Class A and 17,135 rubles / sq. m. / year in Class B.

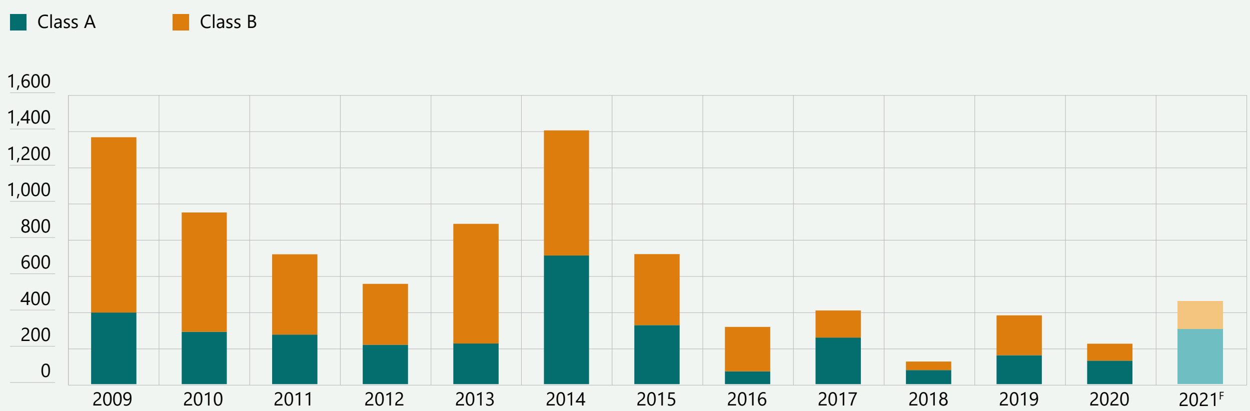
Key indicators. Dynamics*

		2020	2019
Total stock, '000 sq m		16,998	16,773.5
	Class A	4,594	4,435
	Class B	12,404	12,338
New supply, '000 sq m		224	381
	Class A	129.7	160
	Class B	94.7	221
Vacancy rate, %	Class A	11.7	9.4
	Class B	6.1	7.4
Average weighted asking rental rate*, RUB/sq m/year**	Class A	25,528	24,991
	Class B	17,135	16,820
OPEX rate range*, RUB/sq m/year	Class A	7,100	6,800
	Class B	4,800	4,580

* Excluding operational expenses, utility bills and VAT (20%)

Source: Knight Frank Research, 2021

Class A and B new supply dynamics



Source: Knight Frank Research, 2021

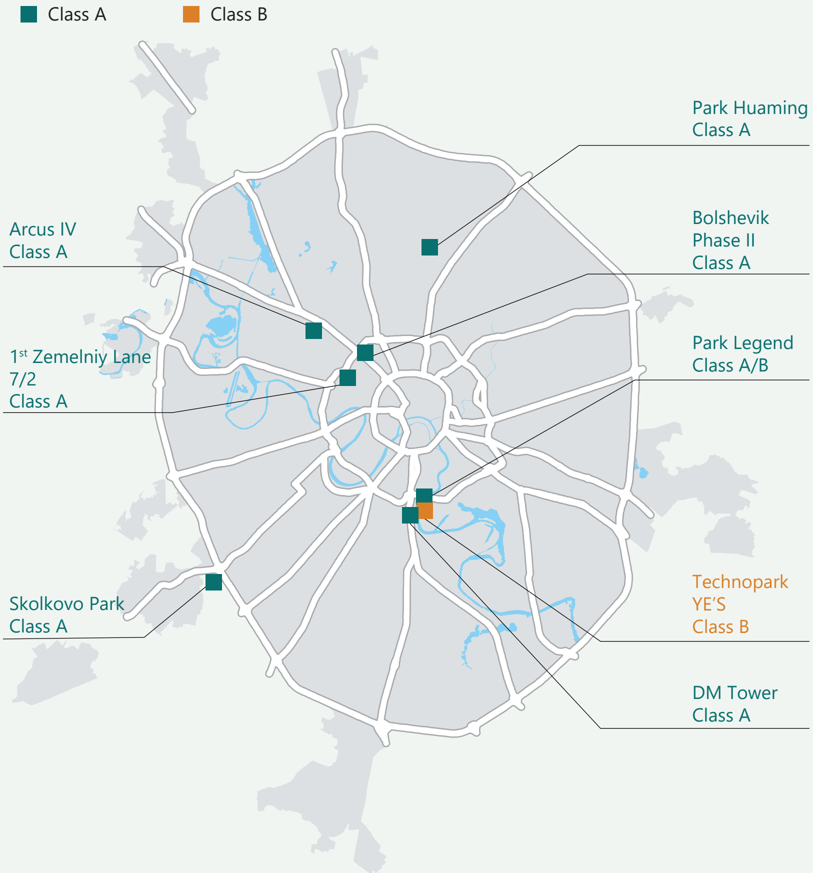
Supply

At the end of 2020, the total supply of offices in the Moscow market amounted to 16.99 million sq. m., including 4.59 million sq. m. of Class A and 12.40 million sq. m. of Class B.

Due to market uncertainty in 2020 and the tangible impact of restrictive measures due to the coronavirus pandemic, which has left its mark on the developers' activity, the total commissioned office space amounted to 224.4 thousand sq. m. instead of 520 thousand sq. m. projected at the end of 2019. The largest facility that entered the market in 2020 was a Class A object — Neva Towers (60,283 sq. m.). Such large facilities as "VTB Arena Park", bld. 8, "Alkon II", MPC "Kvartal West" and others were also officially commissioned. The largest facilities entered the market almost vacant. Therefore, the historically developed business locations, i.e. Moscow-City and the north-western part of Moscow in the Leningrad corridor area, faced high-quality free space supply.

The commissioning of about 450,470 thousand sq. m.is expected in 2021. The dynamics of commissioning and developers' behaviour will largely depend on the speed of market recovery: given the sharp and significant decrease in absorption in 2020, specialized developers may put some of their projects on hold while observing the behaviour of office users and the further vector of market development.

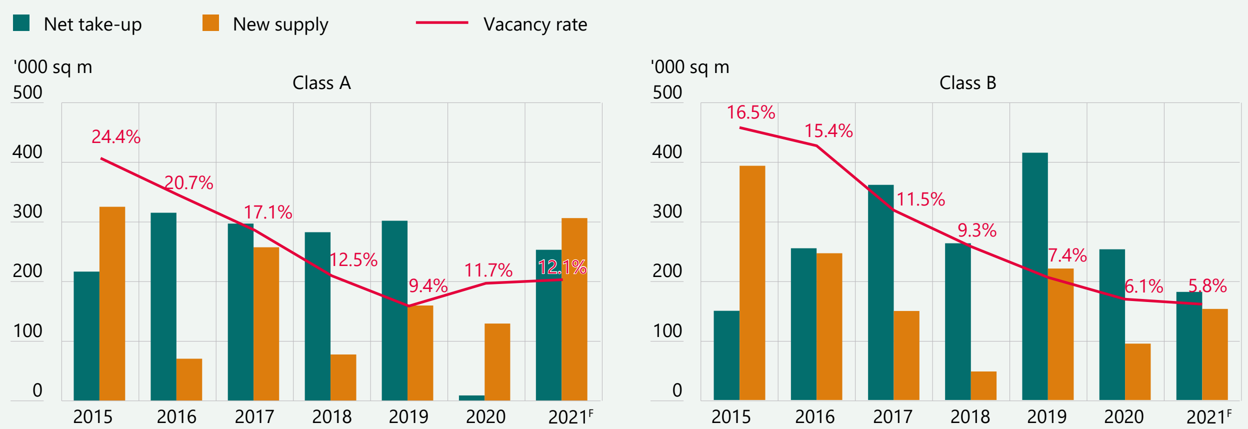
Properties scheduled for delivery throughout 2021



* Office facilities planning to obtain commissioning certificates in Q1 – Q4 2021.
The class of buildings is indicated according to the classification of the Moscow Research Forum 2013

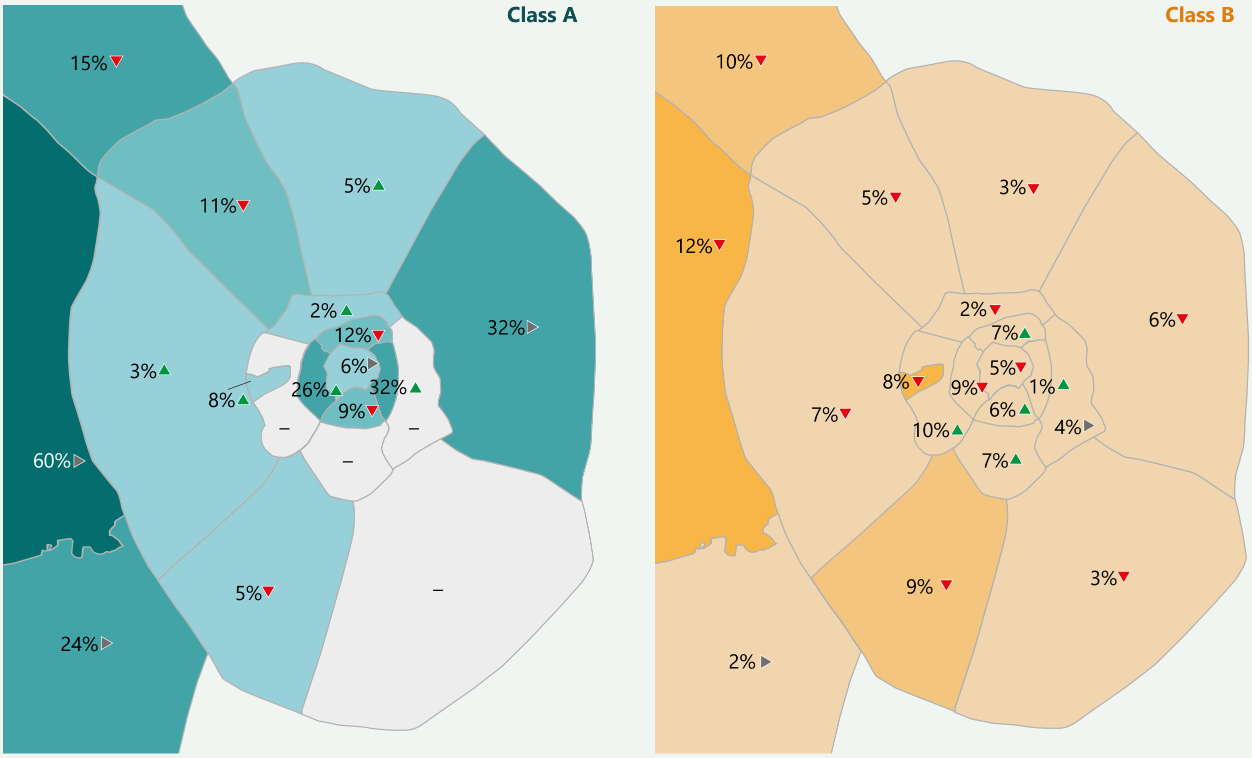
Source: Knight Frank Research, 2021

Net absorption, new supply and vacancy rate dynamics



Source: Knight Frank Research, 2021

Moscow submarket data. Vacancy rate



Source: Knight Frank Research, 2021

The share of vacant space in Class A increased by 2.4 p.p. over the year, up to 11.7%. Currently, 540 thousand sq. m. of offices remain vacant. On the contrary, the indicator in Class B has decreased by 1.3 p.p. since the beginning of the year, to 6.1%. The total volume of vacant space is almost 760 thousand sq. m. The recorded growth in Class A compared to Q4 2019 was the first annual growth in vacancy for the five years. The indicator dynamics was due to the entry into the market of new large projects in this class: "VTB Arena Park", bld. 8 (office area of 28,969 sq m), as well as the Neva Towers project (60,283 sq m), where the space was vacant. It should be noted that the end of the year and the commissioning of Neva Towers played a large part in the indicator growth: e.g., the vacancy rate increased by 1.3 p.p. in Q4 compared to Q3 2020. Further growth (to 12.1 – 12.3%) is expected by the end of 2021 due to the significant share of Class A in the total projected supply in 2021, which may not be filled. On the contrary, the recent years' dynamics continued: the indicator decreased and further decrease is expected (to 5.7-5.8% by the end of 2021) due to the small volume of offices announced for commissioning, as well as the expected seasonal, more dynamic, business activity.

The growth of sublease in the office market may be called one of the trends in 2020: due to restrictive measures and transfer of a certain part of employees to remote working, a significant number of companies decided to free up part of their space for sublease. The total volume of such space is estimated at the level of 150 – 200 thousand sq. m., some of which are still on the market. The companies that made such a decision include, but not limited to, Deloitte, which office is now located in the "Belaya Ploshchad" business center, or KPMG, which also decided to refuse from some of its offices in the "Bashnya na Naberezhnoy" and are subleasing some extra space. A similar trend will continue. Nevertheless, highly liquid offices in the city's iconic properties have been out of reach of most residents over the past few years not only because of the price but also because of the lack of large units supply. This currently makes it possible for companies that not only managed to survive during the pandemic, but also showed growth, to have offices in premium-class facilities. The limited current demand for such expensive space will allow potential tenants to enter the project on relatively favourable terms since there are now few claimers for such units.

In 2020, the owners of classic offices, in contrast to the owners of flexible spaces, were more protected from large-scale abandonment of premises by the impossibility for the tenants of high-quality properties to unilaterally withdraw from contracts, which would potentially restrain the dramatic growth in the share of vacant premises. Moreover, despite the general increase in Class A vacancy since the beginning of the year, there is still a shortage of high-quality office space supply in the key business locations of the capital, i.e. Moscow-City Moscow International Business Center and the Central Business District. As a solution, tenants can choose to sublease the space or transfer part of their space to a professional operator for management and sale.

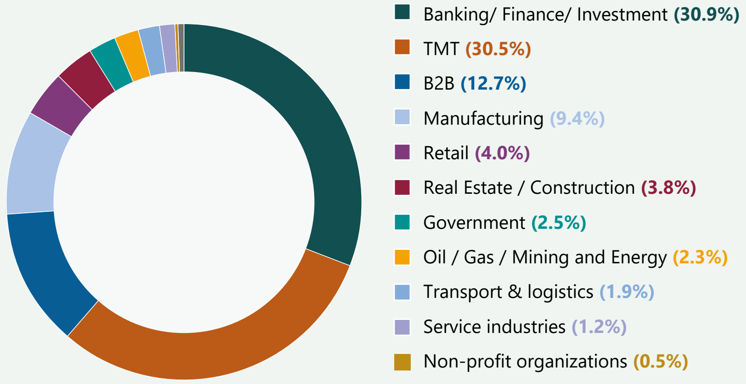
A large volume of transactions on the business terms revision as well as complete or partial refusal of tenants from premises was recorded in 2020, with the base scope of such deals at the year-end. In Q4 2020, about 65–70% of the transactions were those to revise and extend business terms, while in this share was only 25–30% in Q1 – Q3. The burst of such activity most likely means the end of negotiations between tenants who decided to reconfigure their spaces in the first months of restrictive measures due to the pandemic. At the beginning of 2021, this activity is expected to continue: tenants will continue to look for better options and optimize operating rental costs.

Demand

The volume of offices absorption, that is a key indicator of demand demonstrating for a certain period the difference between all the spaces that have become filled and all those that have entered the market empty, significantly decreased in 2020 and amounted to only 262.1 thousand sq. m., which is 64% less than a year earlier. The annual absorption rate decreased to the level below the post-recession 2015, when it amounted to 367 thousand sq.m. Such dynamics was influenced by a decrease in rental activity and the freeing of a number of the premises of current tenants. In 2021, a gradual recovery in demand for offices is expected and the possibility of implementing deferred demand remains. The projected absorption is 436 thousand sq. m., + 65% YoY.

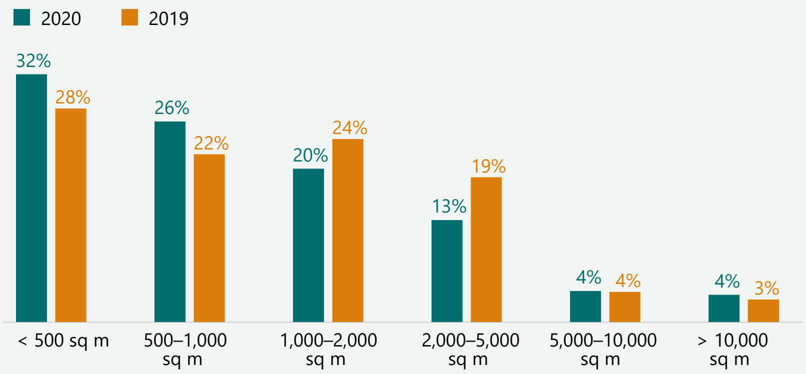
Banks and financial companies, as well as companies in the TMT sector (Technologies / Media / Communications) were leaders in 2020 in the structure of demand for offices, with a share of 31% each. The largest transaction of the year was the preliminary lease by Tinkoff Bank of the entire office space of the AFI Square project, which is scheduled to be commissioned in 2022. The deal is landmark and one of the largest ever observed. The third place was taken by companies in the B2B sector, with a share of 12.7%.

Take-up structure by business sector



Source: Knight Frank Research, 2021

Distribution of leased office units by size



Source: Knight Frank Research, 2021

Key lease and sale deals in Moscow office market, 2020

Company	Area, sq m	Transaction type	Office building
Tinkoff Bank	77,839	Lease	AFI Square
Alfa Strakhovanie	27,736	Sale	Park of Legends
Space 1	11,644	Lease	New Balchug
City Mobil ⁂	11,103	Lease	Alcon
Rubytech	11,022	Lease	Kalibr Technopark
Mail.ru ⁂	8,764	Lease	Alcon II
Novartis	7,621	Lease	Alcon II

⁂ Knight Frank deals

Source: Knight Frank Research, 2021

Commercial Terms

Against the observed market conditions and the slowdown in the key indicators, office rental rates have changed insignificantly. The asked rental rate in Class A offices for the year associated with the pandemic increased by 2.1% and is now at the level of 25,528 rubles / sq. m. / year (excluding operating expenses and VAT). On a quarterly basis, the growth was 0.9%. The modest growth rate is due to the new buildings entering the market with rates above the average, which leads to an increase in the average weighted figure. The asked rates in individual objects do not grow. The rental rate in Class B also slightly increased compared to the beginning of the year — by 1.3%, i.e. to 17,135 rubles/sq. m./ year (excluding operating expenses and VAT), compared to the previous quarter, the growth amounted to 2.5%.

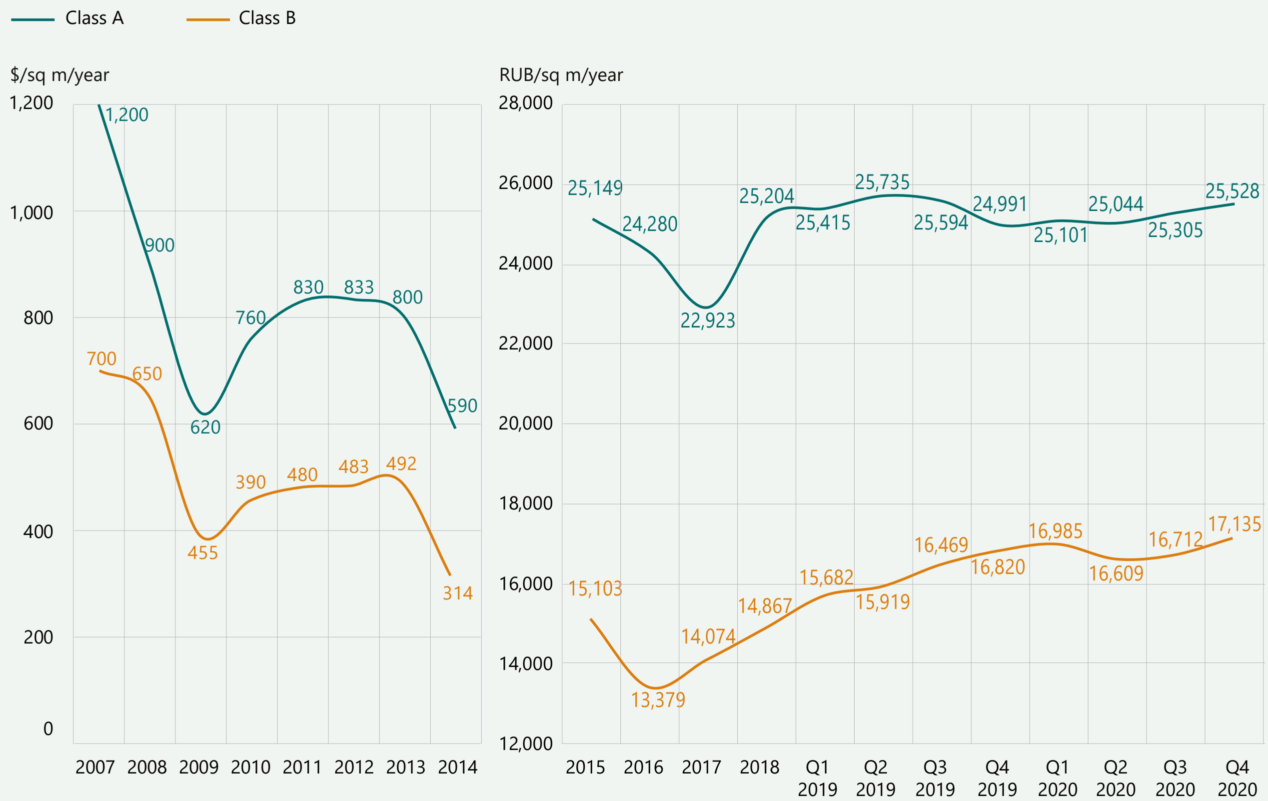
No significant increase in the price of current vacant offices is expected in 2021. Moreover, in buildings with a high volume of vacant space, owners will be more flexible in dealing with potential tenants in order to accelerate the sale of the current vacant space. As large facilities that entered the market at the end of 2020 with significant free space are filled, rates may slightly adjust.

The existing market practices remain unchanged. The average term under office lease agreements is still 5 years with the possibility of early termination. The indexation of rental rates in most contracts is tied to the consumer price index but remains a reason for negotiations, since tenants and owners of business centers understand that rental rates and inflation rates may rise in 5 years.

The area of the leased office unit is the main factor in the deviation of the achievable rental rate from the asked one: developers often prefer to lease a building to several large tenants instead of a mono-tenant or division of space into small units. This creates a stable rental income for them that is less dependent on rotation, on the one hand, and not so difficult to administer, on the other.

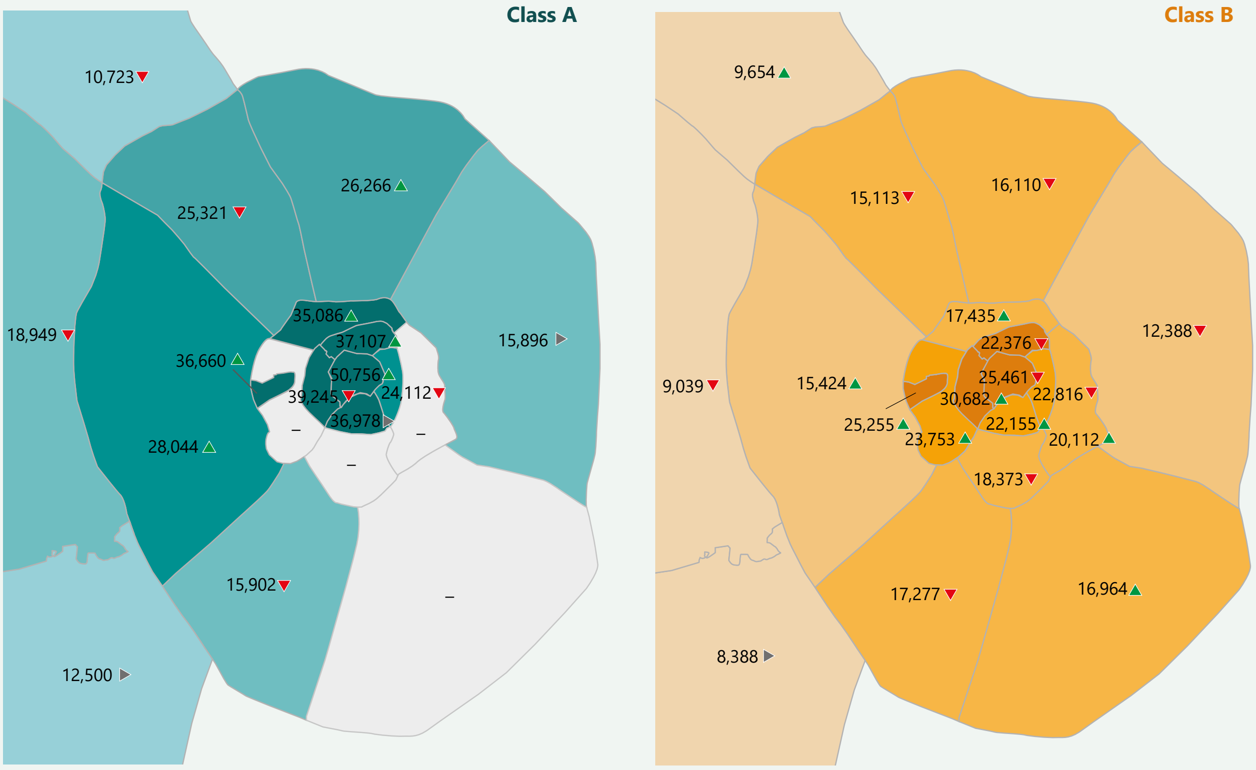
Offices are mostly leased "as is", and compensation for finishing by the owner is often minimal or absent.

Class A and B average weighted asking rents dynamics



Source: Knight Frank Research, 2021

Moscow submarket data. Average weighed rent



Source: Knight Frank Research, 2021

Forecast

Due to a serious decrease in demand for offices, developers are now showing restrained activity in facility commissioning while monitoring the behaviour of office users. Nevertheless, in 2021, the commissioning of new facilities may amount to 460 thousand sq. m., where almost 67% will be Class A projects. In the event of unforeseen adverse situations and low rates of market recovery, the indicator at the end of 2021 may turn out to be lower.

Due to the gradual segment recovery, the net absorption rate in 2021 is projected at 420-440 thousand sq. m., which is about 60-70% more than in the recession year of 2020.

The reduced construction activity in the past few years helped to avoid a situation similar to the recession of 2014, when over 1 million sq.m. of new space entered the market and the significant increase in vacancy was observed against a sharp drop in demand. Nevertheless, taking into account the sharply reduced demand for office space as well as the continuing uncertainty, a further increase in the vacancy rate share in Class A is expected in 2021. The figure may reach 12.0 – 12.2%. As for Class B, a moderate reduction is expected due to the small amount of offices announced for commissioning as well as the continued rental activity in this class: the vacancy rate at the end of the year will be about 5.8%.


Neva Towers

Office Space Sales Market

The office sales market in the Moscow office market can be roughly divided into two segments: transactions to buy the so-called small-size "retail offices" (up to 500 sq. m.) and major purchases of entire buildings (which has seldom happened recently). In both cases, the space can be used both for their own offices and for further leasing to other companies. At the same time, if when buying small offices the achievable sale price slightly differs from the asked one, then in the case of major purchases a significant price reduction will be possible in both Class A and Class B offices.

The average weighted price for office units in Class A facilities amounts to 234,295 rubles/sq m, in Class B offices — to 148,095 rubles/sq m, and in mansions — to 314,008 rubles/sq m. The average weighted price of general purpose area located on the ground floors of residential complexes is 144,526 rubles/sq m.

Moscow submarkets. Average weighted sale price*.

	Class A	Class B	Mansion	Premises for free use
Boulevard Ring	–	378 571	387 966	454 283
Garden Ring	316 362	221 611	340 140	310 879
Third Transport Ring	236 410	177 155	222 890	153 762
TTR-MKAD	199 021	122 600	253 683	109 202
Outside MKAD	129 600	85 111	–	100 998

* Excluding VAT (20%).

Source: Knight Frank Research, 2021

Technopark YE'S

Moscow submarket data. Key indicators*

Submarket		Lease Area, thousand. sqm	Class A Average rent, RUB/sq m/year*	Class A Average rent, RUB/sq m/year* (total)	Class A Vacancy rate, %	Class A Vacancy rate, % (total)	Class B Average rent, RUB/sq m/year*	Class B Average rent, RUB/sq m/year* (total)	Class B Vacancy rate, %	Class B Vacancy rate, % (total)
Boulevard Ring	Central business district	712	50,756		6.0		25,461		5.3	
Garden Ring	South	999	36,978	34,786	9.0	13.8	22,155	26,324	6.4	6.3
	West	561	39,245		26.1		30,682		9.0	
	North	667	37,107		12.1		22,376		7.0	
	East	407	24,112		32.0		22,816		0.7	
Third Transport Ring	South	1,282	–	31,184	–	1.4	18,373	20,673	7.0	5.9
	West	797	–		–		23,753		9.8	
	North	975	35,086		2.4		17,435		2.4	
	East	1,133	–		–		20,112		4.0	
	MIBC Moscow-City	1,233	36,660		8.2		25,255		7.9	
TTR-MKAD	North	1,052	26,266	22,732	5.0	9.0	16,110	15,584	2.6	5.5
	Northwest	870	25,321		10.5		15,113		5.4	
	South	2,061	28,044		3.4		15,424		6.7	
	West	1,454	–		–		16,964		7.0	
	Southwest	662	15,902		5.5		17,277		9.4	
	Preobrazhenskiy	1005	15,896		32.3		12,388		5.9	
Out MKAD	Khimki	266	18,949	15,243	15.1	29.5	9,654	9,270	9.7	9.3
	West	515	10,723		60.3		9,039		11.8	
	New Moscow	345	12,500							
Total		**16,997**	**25,528**		**11.7**		**17,135**		**6.1**	

* Excluding OPEX and VAT (20%)

Source: Knight Frank Research, 2021

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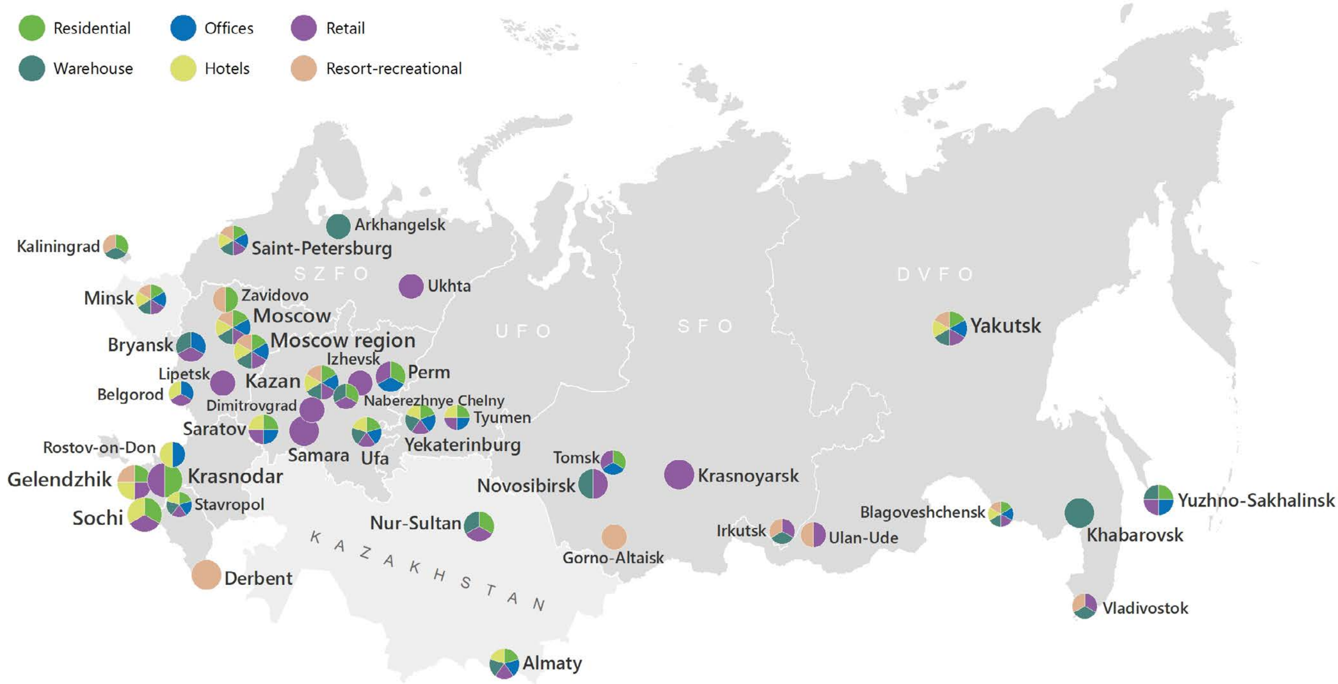

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