RESEARCH

Q1 2019

OFFICE MARKET REPORT

Moscow

HIGHLIGHTS

As of Q1 2019, the new delivery of quality office premises amounted to 27,500 sq m.

The vacancy rate stood at 11.5% for Class A offices and at 8.7% for Class B offices at the end of Q1 2019, which totals to about 1.54 million sq m in figures.

The average asking rent rates grew by 0.8% to 24,425 rub/sq m/year for Class A offices.

Konstantin Losiukov
Director Office Department
Knight Frank

«Q1 2019 turned out to be quite smooth and predictable for the office market. Similar to 2018, the balance of new delivery and net absorption was the key driver of all market changes. Thus, the low new delivery along with the solid demand were causing the vacancy rate to decline and the rent rates to grow. In terms of the demand, the banks and financial organizations proved to play an important role during Q1, while TMT companies yet again showed a strong performance in terms of growth and new absorption. All in all, the market has completely stabilized in terms of its trends that are hardly going to change in the near future.».

OFFICE MARKET REPORT MOSCOW

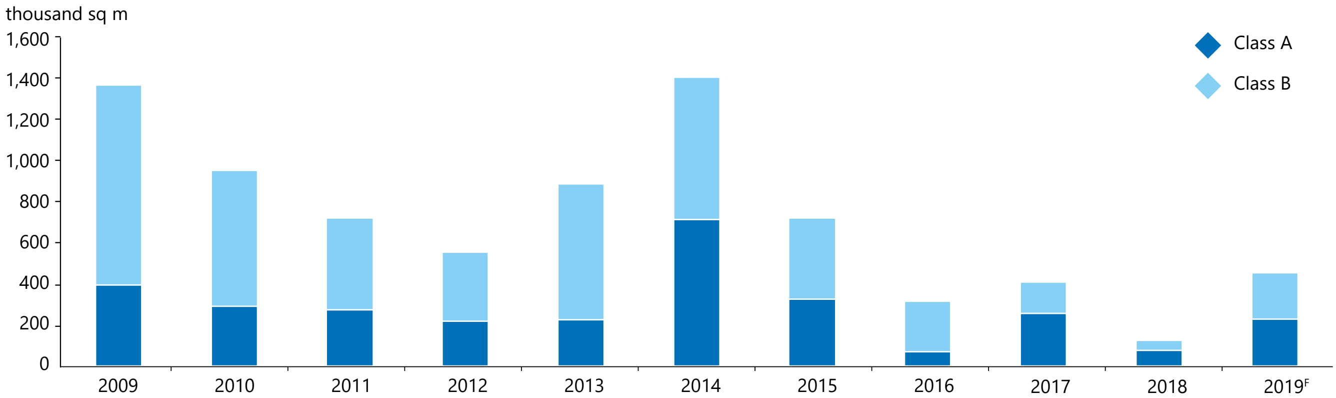
Key indicators. Dynamics*

		Q1 2019	Q4 2018
Total stock, thousand sq m		16,415	16,388
including:	Class A	4,226	4,226
	Class B	12,189	12,162
Deliveries Q1 2019, thousand sq m		27.5 ▼	37**
including:	Class A	–	–
	Class B	27.5 ▼	37
Net take-up Q1 2019, thousand sq m		180 ▲	174**
Vacancy rate, %	Class A	11.5 ▼	12.5
	Class B	8.7 ▼	9.3
Average weighted asking rental rate***, RUB/sq m/year	Class A	25,415 ▲	25,204
	Class B	15,682 ▲	14,867
OPEX rate range***, RUB/sq m/year	Class A	6,800 ►	6,800
		4,580 ►	4,580

* Compared to Q4 2018
** The value for Q1 2018
*** Excluding operational expenses, utility bills and VAT (20%). OPEX rate does not consider change related to property tax rate increase

Source: Knight Frank Research, 2019

Class A and B new delivery volume dynamics



Source: Knight Frank Research, 2019

Supply

As of Q1 2019, the total stock of quality office spaces of Moscow amounted to 16.4 million sq m, 25.7% of which are Class A properties and 74.3% are Class B properties.

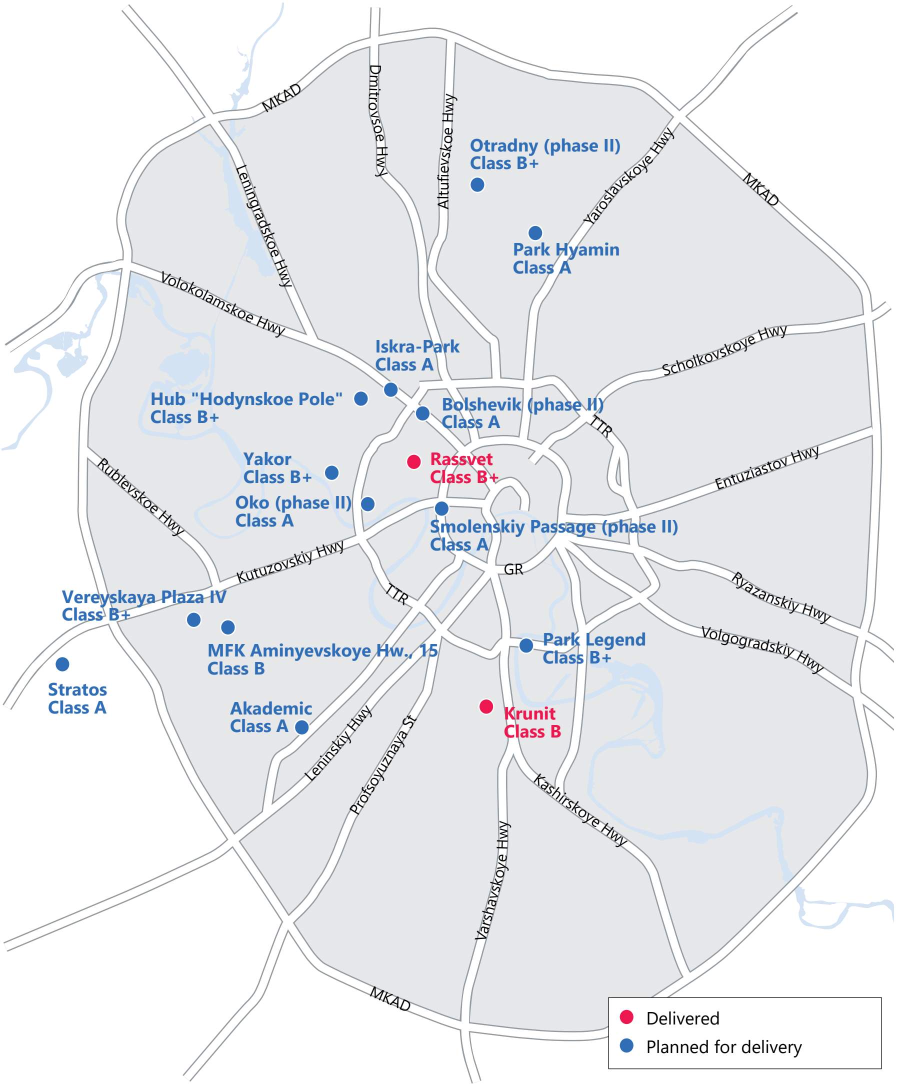
As many as 27,500 sq m of quality office premises were delivered in Q1 2019, which is 25% less than a year ago. It is worth mentioning, that all the properties delivered in Q1 2019 were Class B premises. Despite the new delivery declines in Q1 2019, 450,000 sq m of quality office spaces are expected to be delivered throughout the year, which is 3.5 times the figure of 2018.

The low new delivery along with the strong demand, which includes a number of large office spaces of over 5,000 sq m going off the market, resulted in the vacancy rate for Class A offices declining by one percentage point to 11.5% or 486,000 sq m in Q1 2019 as compared to the end of 2018.

As for Class B offices, just like in 2018, the strong demand continues to cause a decline in the vacancy rate despite some new Class B properties were delivered in Q1 2019. Thus the vacancy rate for Class B premises dropped by 0.6 percentage points to 8.7% or 1,060,000 sq m in figures over the first three months of the year.

The cumulative volume of vacant premises in Class A and B offices amounted to 1.54 million sq m. Further decline is expected in both Class A and B offices by the end of 2019. Meanwhile, thanks to the announced new delivery of quality office properties, the vacancy rate is not expected to

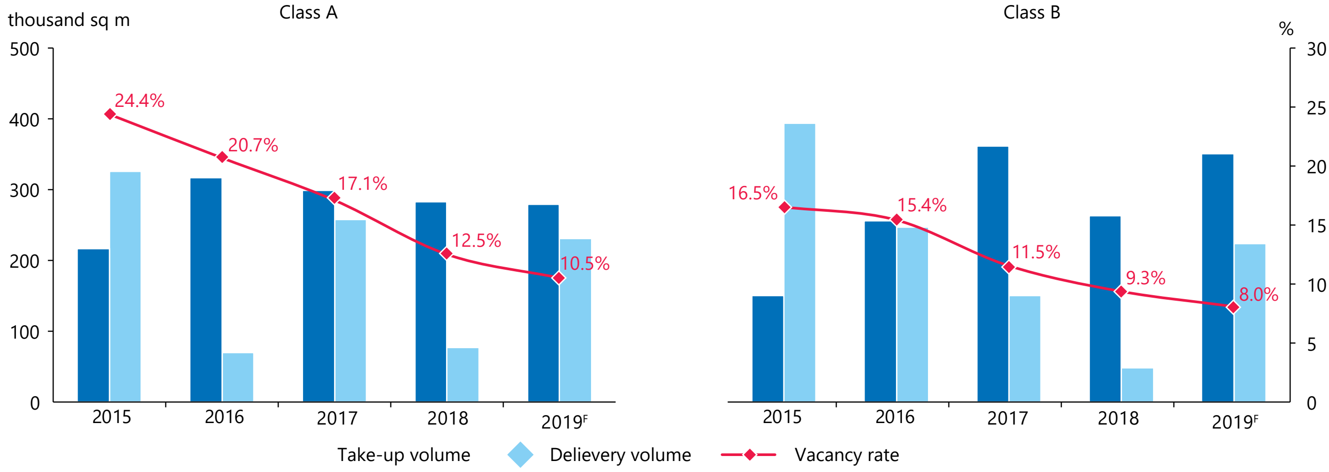
Properties delivered in Q1 2019* and scheduled for delivery throughout 2019



* Офисные объекты, получившие Акт ввода в эксплуатацию в 2018 г. Класс зданий указан согласно классификации Московского Исследовательского Форума 2013 г.

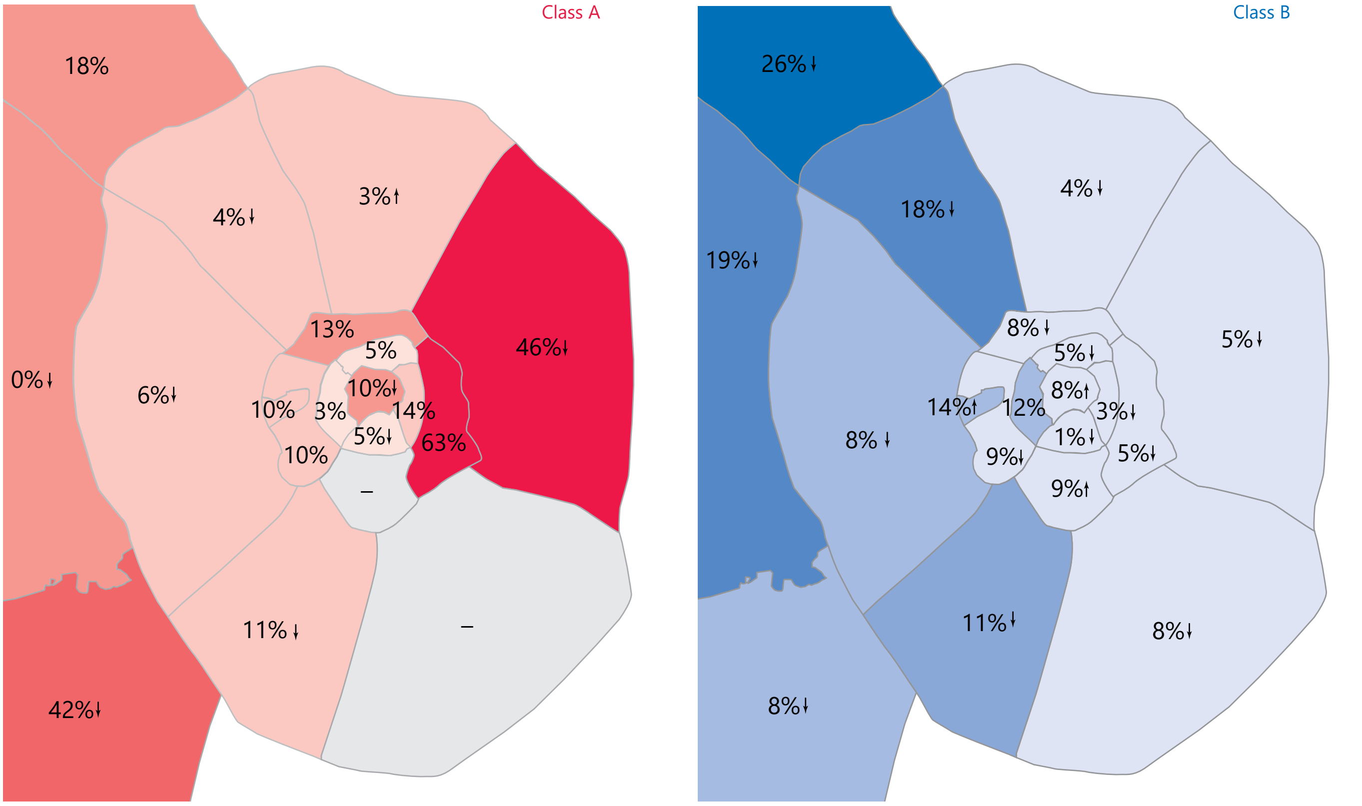
Source: Knight Frank Research, 2019

The net take-up and vacancy rate dynamics



Source: Knight Frank Research, 2019

Moscow submarket data. Vacancy rate



Source: Knight Frank Research, 2019

drop significantly as compared to 2018, when the figure decreased by 4.6 percentage points for Class A offices and by almost two percentage points for Class B offices yoy.

The most noticeable change in the vacancy rate among all Moscow business districts was as follows in Q1 2019:

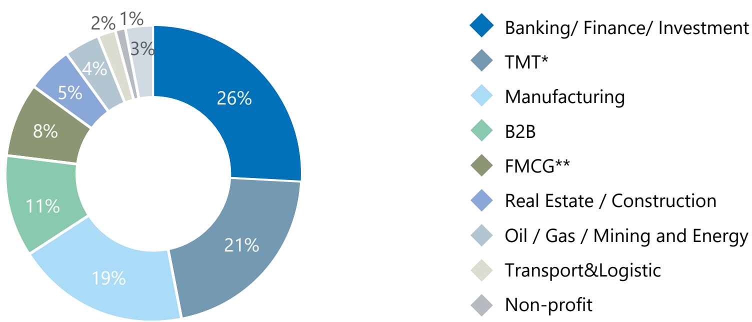
- The vacancy rate dipped by four percentage points to 8.9% or 27,000 sq m for Class B offices in the district of the Third Transportation Ring and the Moscow Ring Road-North in Q1 2019, the reasons for what included some large office blocks in Seven One Business Center (4,000 sq m) and Quadrum Business Center (13,000 sq m) having gone off the market.
- The vacancy rate for Class B offices fell down by three percentage points to 12.8% or 80,800 sq m in the west of Moscow between the Third Transportation Ring and the Moscow Ring road due to several transaction with Vereyskaya Plaza III Business Center, Dorokhov Business Center, and Grand Setun Business Center.

Demand

The take-up pace for the office premises of Moscow remained strong in Q1 2019 as it was during 2018; The net absorption amounted to 180,000 sq m, which in general matches the figure of Q1 2018, namely 174,000 sq m.

As long as the current office market state can be generally described as stable, the figures of Q1 2019 all in all match the figures of 2018 and Q1 2018 in particular. For instance, the share of new lease transactions a mounted to 68% of all trading volume, which

Distribution of leased office space by sector



* Technology, media and telecommunications
** Fast moving consumer goods

Source: Knight Frank Research, 2019

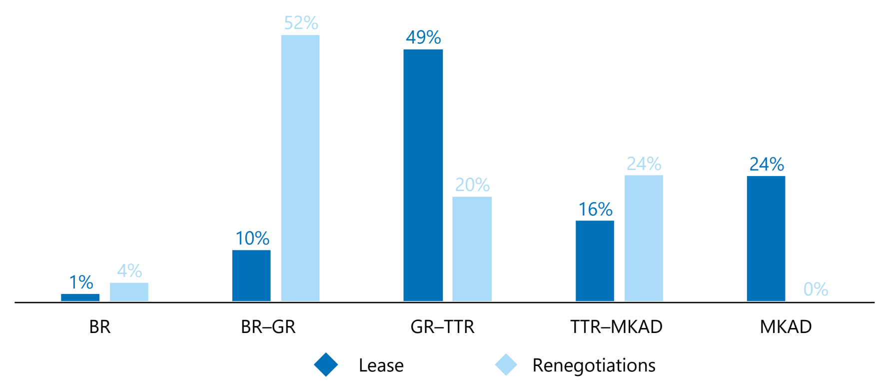
basically corresponds to the figure of Q1 2018 (66%).

Unlike the past two or three years, when the companies partially owned by the state were among the key tenants of office spaces, the companies of such profile did not show a strong performance in Q1 2019, with their share of less than 1% of all transactions. Financial and banking sector companies are currently leading the way; Their share in the transactions volume amounted to 26% in Q1 2019. The largest deal of the first three months of the year contributed greatly into such a result. It was the lease of 15,500 sq m in OKO II Business Center by Rosbank. The Technology/Media/Telecommunications companies are as active as before, with their share of 21% of all deals.

The share of new lease transactions within the Moscow Ring Road showed an annual growth in Q1 2019. However, the first quarter of the year is historically less busy as the other quarters, so the number of transactions is generally lower. Therefore, we can't make a conclusion about the growth in demand for the office centers outside the Moscow Ring Road due to the limited selection. The district near the Third Transportation Ring is very popular with the tenants, as usual. Thus, almost 50% of all new lease transactions were signed here in Q1 2019.

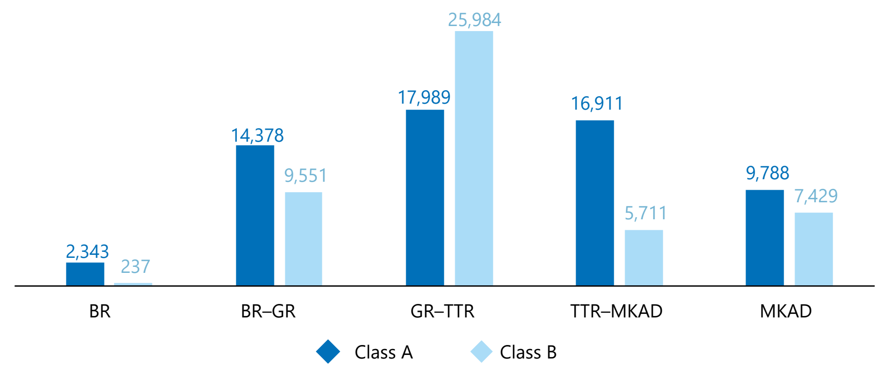
The demand for the office blocks of over 5,000 sq m grew insignificantly in Q1 2019

Distribution of transactions by type and location



Source: Knight Frank Research, 2019

Distribution of leased office space by location



Source: Knight Frank Research, 2019

Key lease and purchase transactions closed in Q1 2019

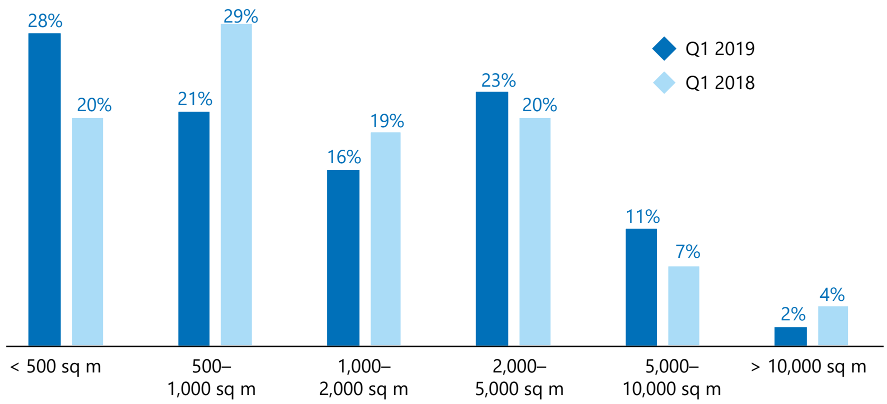
Company	Area, sq m	Office building	Class	Address	Transaction type
Rosbank	15,415	OKO II	A	1st Krasnogvardeisky passage, 21, 2	Lease
Coca Cola	5,400	Comcity	A	Kievskoe Hwy., 22 km	Lease
OKEY	5,000	Kristall	B+	Kyrovogradkaya st., 23	Lease
Law Office "Egorov, Puginsky, Afanasyev and Partners"	4,850	Four Winds	A	1st Tverskaya-Yamskaya st.,21	Lease
Yandex.Market	3,900	Workki	Coworking	Zubovsky blv	Lease
Coworking SOK	3,400	Federation Tower. East	B+	Presnenskaya emb., 12	Lease
Sberbank Service	3,000	Novosushevsky	B+	Sushevsky Val st., 18	Lease

Source: Knight Frank Research, 2019

as compared to the same period last year. Thus, while the share of lease deals with the office blocks of such size amounted to 11% a year ago, it rose to 13% now. These figures partially support the trend Knight Frank Research noted, namely the consolidation of office premises by numerous major companies. The demand for the office spaces under 1,000 sq m (which is 49% of all deals) and those of 1,000-5,000 sq m in area (39% of all deals) generally hasn't changed as compared to Q1 2018, which is another indicator of the market stability.

As compared to Q1 2018, the average transaction size decreased by 23% in Q1 2019 to 1,945 sq m.

Distribution of leased office units by size

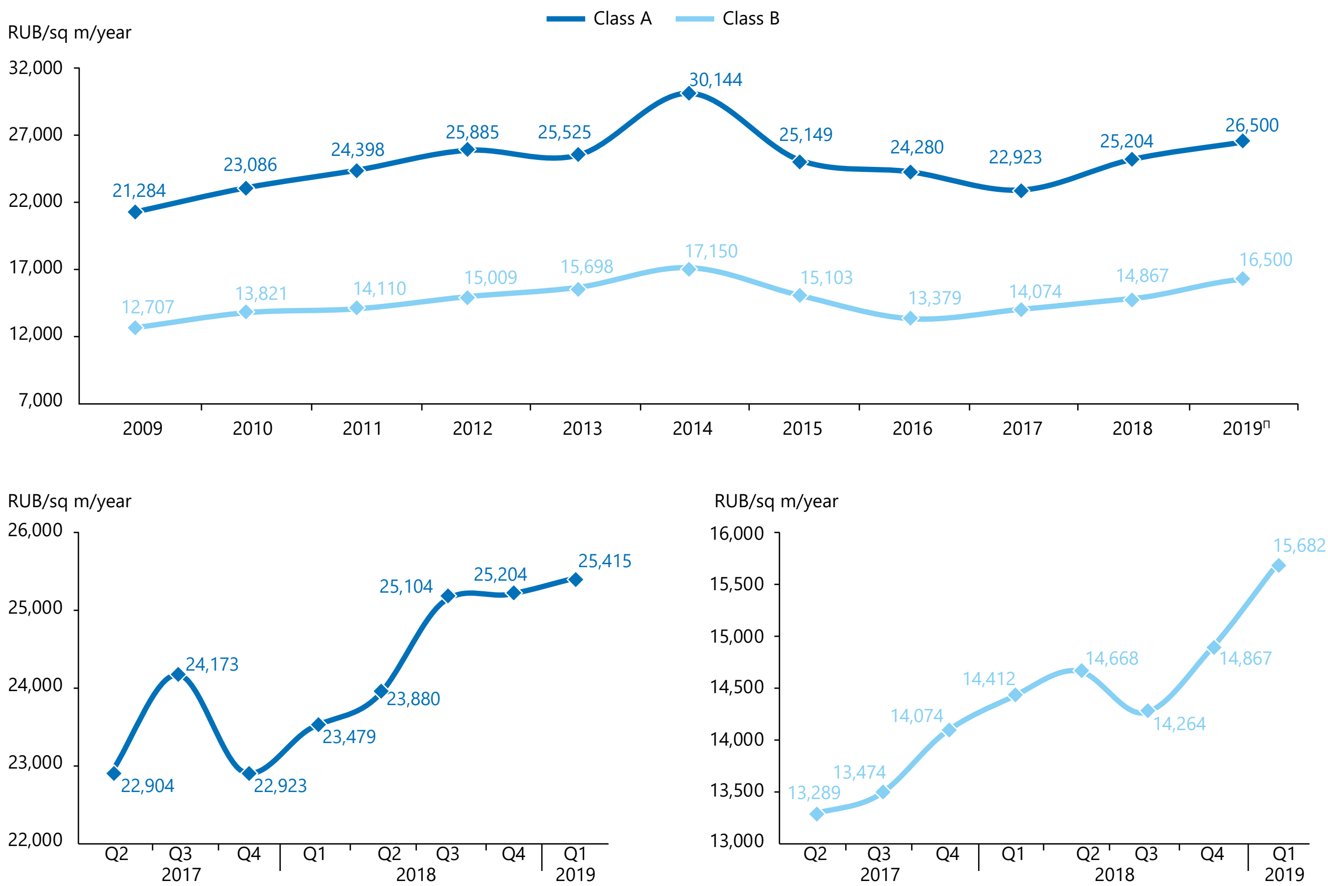


Source: Knight Frank Research, 2019

Commercial terms

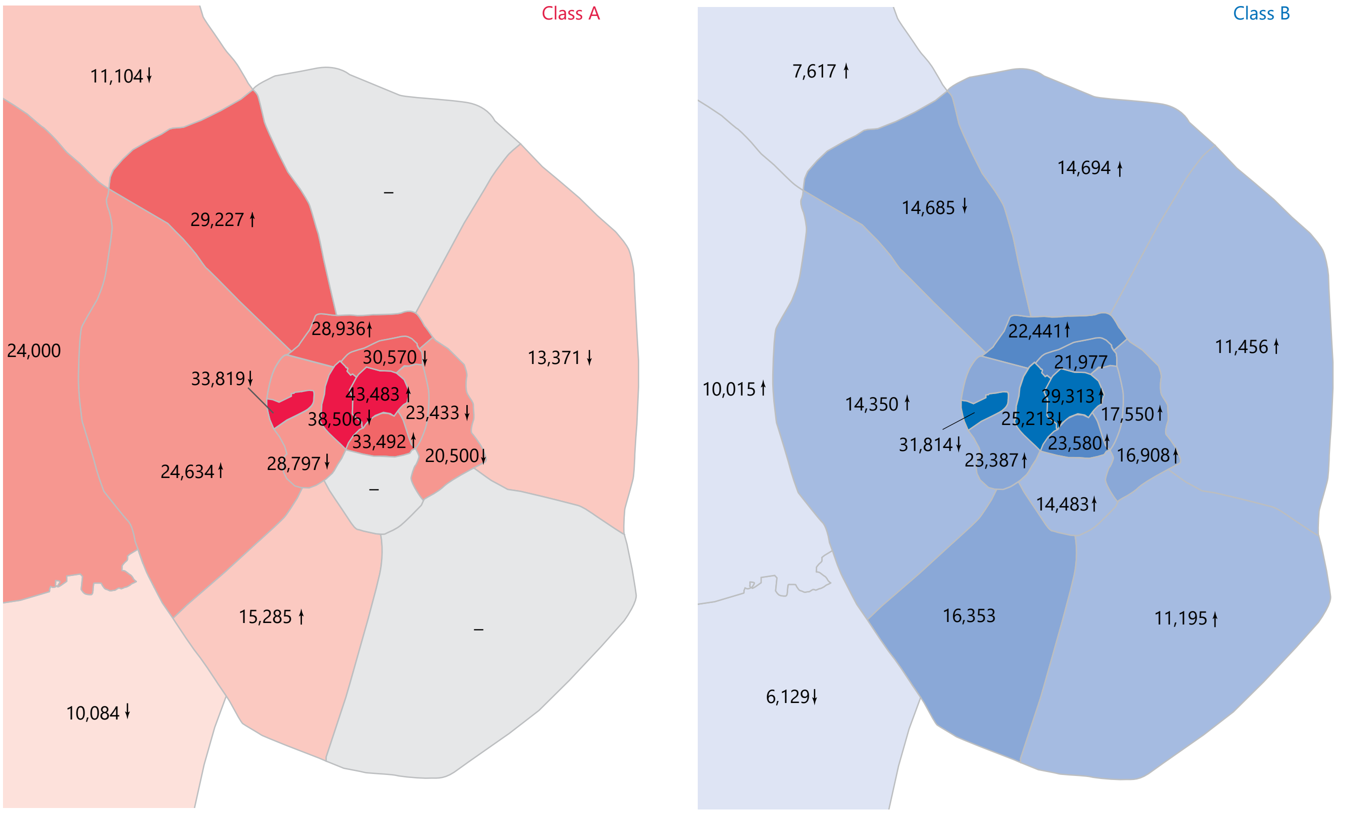
In Q1 2019, the asking rent rates for Class A and B office buildings continued their growth, which had started at the end of 2017. The average weighted asking rent rates rose by 1% to 25,415 rub/sq m/year for Class A properties, as of Q1 2019. Unlike Class A offices, where a slight growth happened mostly because more affordable office blocks went off the market, the growth in Class B was due to that a lot of Class B landlords raised their asking rent rates, just like Class A landlords did in 2018. Thus, the quarterly growth amounted to 5.5% taking the average weighted asking rent rate for Class B offices in Moscow to 15,682 rub/sq m/year in Q1 2019.

Average asking rental rates for Class A and B offices, RUB/ sq m / year



Source: Knight Frank Research, 2019

Moscow submarket data. Average weighed rent



Source: Knight Frank Research, 2019

The most striking changes to the average weighted asking rent rate took place in the following business districts of Moscow in Q1 2019:

- The rent rate grew by 12% to 16,300 rub/sq m/year in the southwest between the Third Transportation Ring and the Moscow Ring Road, due to the growth in prices in iCube Business Center and some expensive blocks in Principal Plaza Business Center having become available.
- Several business centers raised their rent rates in Belorusskiy business district. Among such there are Bolshevik, White Stone, and VTB Arena Park. This resulted in the average weighted asking rent rate growing by 6% to 29,000 rub/sq m/year in the neighborhood.
- The average weighted asking rent rate for Class B offices skyrocketed by 17% to 19,500 rub/sq m/year in the east of the Third Transportation Ring, due to the raise of rent rates in Demidov Dvor Business Center and some office blocks of Tupolev Plaza I Business Center that were more expensive than some other supply in the neighborhood, having become available.
- Due to the growth in the rent rates in Gruzinka 30 Business Center along with new expensive blocks of Zvenigorodskiy Business Center having become available, the rent rates increased by 16% in the west of the Third Transportation Ring. As of Q1 2019, the average weighted asking rent rate amounted to 25,500 rub/sq m/year in the district.

Other commercial terms included into the lease contracts and discussed over the negotiations over Q1 2019 did not change since 2018.

As before, tenants are interested in signing lease contracts for the period of 5 to 7 years, with an early termination possibility. The indexation of rent rates in most contracts is linked to the consumer price index, but it remains subject to negotiating, since both the tenants and the owners of business centers realize that the rent rates and the inflation might grow over the five-year period.

When negotiating, landlords differentiate clients quite substantially according to the leasable area, company name, or the significance of this particular company for the business center. Currently, landlords are prepared to discuss flexible rent conditions only with major and/or unique tenants for a particular business center.

The owners of business centers tend to avoid investing into finishing and pass the premises to tenants 'as is'. Apart from that, a lot of major tenants that are in the middle of their search for new office spaces budget finishing expenses and are ready to consider the properties of any state.

Moscow submarket data. Average sale price*

	Class A, RUB/sq m	Class B, RUB/sq m	Mansion, RUB/sq m	Premises for free use, RUB/sq m
Boulevard Ring	–	375,000	405,881	354,519
Garden Ring	265,909	187,214	682,199	302,822
Third Transport Ring	282,542	131,355	241,312	193,240
TTR–MKAD	213,340	117,551	171,593	186,467
Out MKAD	208,843	111,587	96,406	–
Total	**252,248**	**128,555**	**210,127**	**265,468**

* Excluding VAT (20%)

The price calculated for delivered properties.

Source: Knight Frank Research, 2019

Forecast

A growth in new delivery is forecast to amount to about 450,000 sq m in 2019. Further on, we expect the new delivery of quality office centers to pick up the pace in Moscow, providing the demand remains strong. The key properties that are scheduled for delivery in 2019 are Iskra Park Business Center (GLA – 56,000 sq m), Vereyskaya Plaza IV Business Center (GLA – 50,000 sq m), Akademik Business Center (GLA – 47,000 sq m), 'Stratos. Skolkovo Innovation Center' Business Center (GLA – 30,000 sq m), Bolshevik Business Center (phase II, GLA – 25,000 sq m), and Smolenskiy Passage (phase III, GLA – 11,000 sq m).

Some developers who have properties in highly liquid locations have moved from a frozen stage to active construction. Alcon II Business Center and Alcon III Business Center are among such. The construction of new office skyscrapers is planned in Moscow City business district.

Despite the rise in new delivery, the vacancy rate is set to decline further on to 10.5% for Class A offices and to 8% for Class B offices. The net absorption will amount to about 600,000–650,000 sq m in 2019.

The average weighted asking rent rates will keep growing in the office market of Moscow. Thus, the average weighted asking rent rate will grow up to 26,500 rub/sq m/year for Class A offices and to 16,500 rub/sq m/year for Class B offices by the end of 2019.

Office sales

Due to the fact that new properties were entered into Knight Frank property database, the sales prices may differ from those of former years.

The demand for the premises for sale in properties under construction currently targets the spaces of 100–400 sq m in area in Class A business centers.

Apart from end user purchases, there is a rise in demand on the part of private investors. The most popular request is for investing 100 through to 300 million rubles into purchasing a ready-to-go rental business in a new Class A or B+ business building, as well as buying office spaces for further lease and generating a regular rental income.

The average weighted prices amounted to 252,248 rub/sq m for Class A office blocks, 128,555 rub/sq m for Class B properties, and 265,468 rub/sq m for mansions. The average weighted price for general purpose premises on the ground floors of residential complexes stands at 210,127 rub/sq m.

KRUNIT, Nagornaya St, 3 bld 1

Moscow submarket data. Key indicators*

<table>
<tr><th colspan="2" rowspan="2">Submarket</th><th rowspan="2">Lease Area, thousand. sqm</th><th colspan="4">Class A</th><th colspan="4">Class B</th></tr>
<tr><th colspan="2">Average rent, RUB/sq m/year*</th><th colspan="2">Vacancy rate, %</th><th colspan="2">Average rent, RUB/sq m/year*</th><th colspan="2">Vacancy rate, %</th></tr>
<tr><td>Boulevard Ring</td><td>Central business district</td><td>712</td><td colspan="2">43,483</td><td colspan="2">10.2</td><td colspan="2">29,313</td><td colspan="2">7.7</td></tr>
<tr><td rowspan="4">Garden Ring</td><td>South</td><td>985</td><td>33,492</td><td rowspan="4">31,767</td><td>4.9</td><td rowspan="4">5.7</td><td>23,580</td><td rowspan="4">23,163</td><td>1.2</td><td rowspan="4">5.3</td></tr>
<tr><td>West</td><td>546</td><td>38,506</td><td>2.8</td><td>25,213</td><td>11.7</td></tr>
<tr><td>North</td><td>665</td><td>30,570</td><td>4.9</td><td>21,977</td><td>4.9</td></tr>
<tr><td>East</td><td>407</td><td>23,433</td><td>14.0</td><td>17,550</td><td>3.2</td></tr>
<tr><td rowspan="5">Third Transport Ring</td><td>South</td><td>1,263</td><td>–</td><td rowspan="4">31,237</td><td>–</td><td rowspan="4">11.2</td><td>14,483</td><td rowspan="4">19,783</td><td>9.4</td><td rowspan="4">8.3</td></tr>
<tr><td>West</td><td>797</td><td>28,797</td><td>9.5</td><td>23,387</td><td>8.5</td></tr>
<tr><td>North</td><td>975</td><td>28,936</td><td>13.3</td><td>22,441</td><td>7.5</td></tr>
<tr><td>East</td><td>1,121</td><td>20,500</td><td>62.7</td><td>16,908</td><td>5.0</td></tr>
<tr><td>MIBC Moscow-City</td><td>1,153</td><td colspan="2">33,819</td><td colspan="2">10.1</td><td colspan="2">31,814</td><td colspan="2">14.3</td></tr>
<tr><td rowspan="6">TTR-MKAD</td><td>North</td><td>1,003</td><td>–</td><td rowspan="6">23,010</td><td>–</td><td rowspan="6">9.6</td><td>14,694</td><td rowspan="6">13,816</td><td>3.8</td><td rowspan="6">8.1</td></tr>
<tr><td>Northwest</td><td>741</td><td>29,227</td><td>4.5</td><td>14,685</td><td>18.3</td></tr>
<tr><td>South</td><td>1,997</td><td>24,634</td><td>5.7</td><td>14,350</td><td>7.8</td></tr>
<tr><td>West</td><td>1,421</td><td>–</td><td>–</td><td>16,353</td><td>10.6</td></tr>
<tr><td>Southwest</td><td>591</td><td>15,285</td><td>11.0</td><td>11,195</td><td>8.3</td></tr>
<tr><td>Preobrazhenskiy</td><td>992</td><td>13,371</td><td>45.9</td><td>11,456</td><td>4.8</td></tr>
<tr><td rowspan="3">Out MKAD</td><td>Khimki</td><td>266</td><td>11,104,</td><td rowspan="3">12,900</td><td>18.4</td><td rowspan="3">34.6</td><td>7,617,</td><td rowspan="3">8,863</td><td>25.7</td><td rowspan="3">18.6</td></tr>
<tr><td>West</td><td>435</td><td>24,000,</td><td>18.7</td><td>20,015</td><td>19.1</td></tr>
<tr><td>New Moscow</td><td>345</td><td>10,084,</td><td></td><td></td><td></td></tr>
<tr><td colspan="2">Total</td><td>16,414</td><td colspan="2">25,415</td><td colspan="2">11.5</td><td colspan="2">15,682</td><td colspan="2">8.7</td></tr>
</table>

* Excluding OPEX and VAT (20%)

Source: Knight Frank Research, 2019

RESEARCH
Olga Shirokova
Director, Russia & CIS
Olga.Shirokova@ru.knightfrank.com

OFFICES
Konstantin Losiukov
Director
konstantin.losiukov@ru.knightfrank.com

+7 (495) 981 0000