

RESEARCH



2018
INVESTMENT
MARKET
Russia

KEY FINDINGS

The total volume of investments into the commercial property of Russia as well as the land plots for development amounted to 248.1 billion rubles in 2018.

Offices proved to be the most sought-after sector of the market, with their share accounting for 47% of all investment transactions.

The share of St. Petersburg in the regional investment structure has grown by 21% in 2018 against 12% in 2017.

The share of foreign investments increased by 11 percentage points to 24% of total investments into the Russian property, as compared to 2017.



Igor Roganovich
Head of Capital Markets,
Knight Frank

"We consider it possible that there might be a conservative (not exceeding 10%) growth in the investments into the property market of Russia in 2019 due to the growing demand for the office and industrial sectors, which is likely to amount to 260–280 billion rubles. The increase in investments into the office sector is possible because of the strong demand coming from TMT companies and manufacturers. As for the warehouse property market, the demand on the part of retail and manufacturing companies will be the key driver. In addition to the mentioned factors, M&A deals are likely to happen in 2019, namely those with residential property developers, as well as the purchases of hotel assets by Asian investors. It is our opinion that, just like last year, foreign investors keep showing quite a reserved interest in the Russian property market. We assume that the demand on the part of foreign investors will remain subject to the general economic conditions, the situation with the sanctions and the exchange value of the ruble, even though the yields in rubles are an attractive feature of the local market."

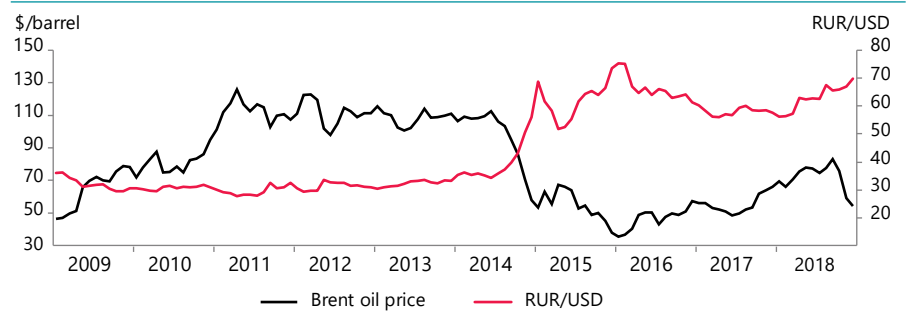
INVESTMENT MARKET

The investment activity in the Russian commercial property market was largely determined by the geopolitical events in the world. Namely, the sanctional pressure from the West had a significant effect onto the market, which led to the depreciation of the ruble against the US dollar by 24% since the beginning of the year.

According to the Ministry of Economic Development and Trade, the growth of the Russian economy amounted to 2% GDP in 2018 against 1.8% a year ago. The slowly growing economy along with the volatility of the ruble and the sanction restrictions coming from the West proved to be the key limiting factors having affected the investments made into the Russian property.

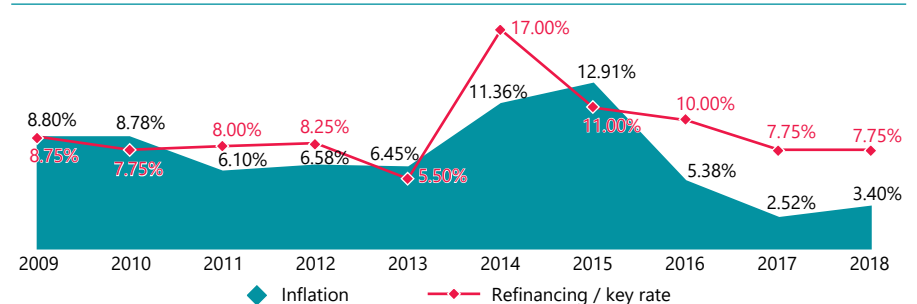
The annual inflation grew by 0.82 percentage points to 3.40% over 2018 against 2017. The key rate changed four times over a year: initially, the Central Bank of Russia decided to lower the key rate from 7.75% to 7.50% per annum in February, then down to 7.25% in March. In September, the Central Bank raised the key rate up to 7.50% for the first time since 2015 and then, in December, it raised it further up to 7.75% per annum. Thus, the key rate went back to the level it was at the beginning of the year. The international rating agency S&P Global Ratings (S&P) confirmed the long-term foreign currency credit rating for Russia as an investment-grade BBB- with a positive outlook. Moody's has raised the sovereign rating of Russia

Historical data of Brent crude oil prices and US dollar exchange rate



Source: Knight Frank Research, 2018, Central Bank of the Russian Federation, 2019

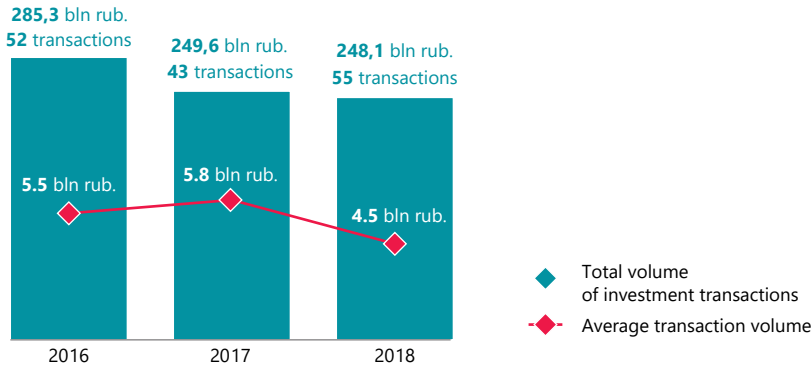
Inflation rate and key rate



* as of the end of the year

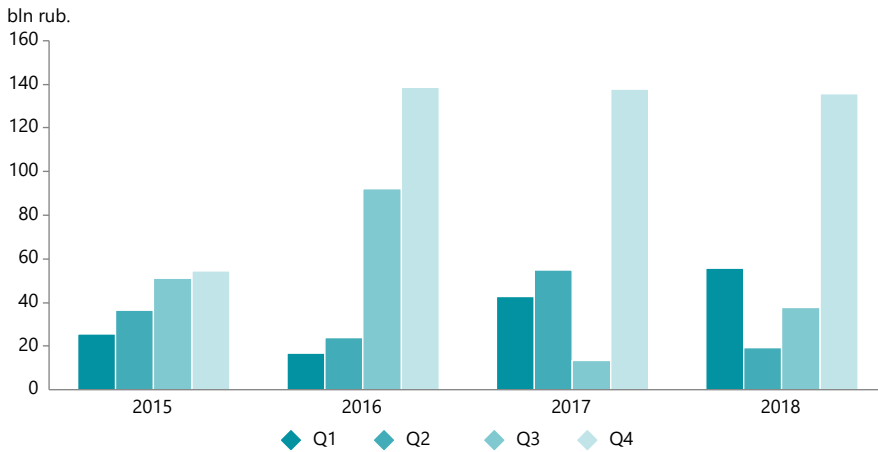
Source: Central Bank of the Russian Federation, 2019

Key figures



Source: Knight Frank Research, 2019

Investment volume increase by quarters



Source: Knight Frank Research, 2019

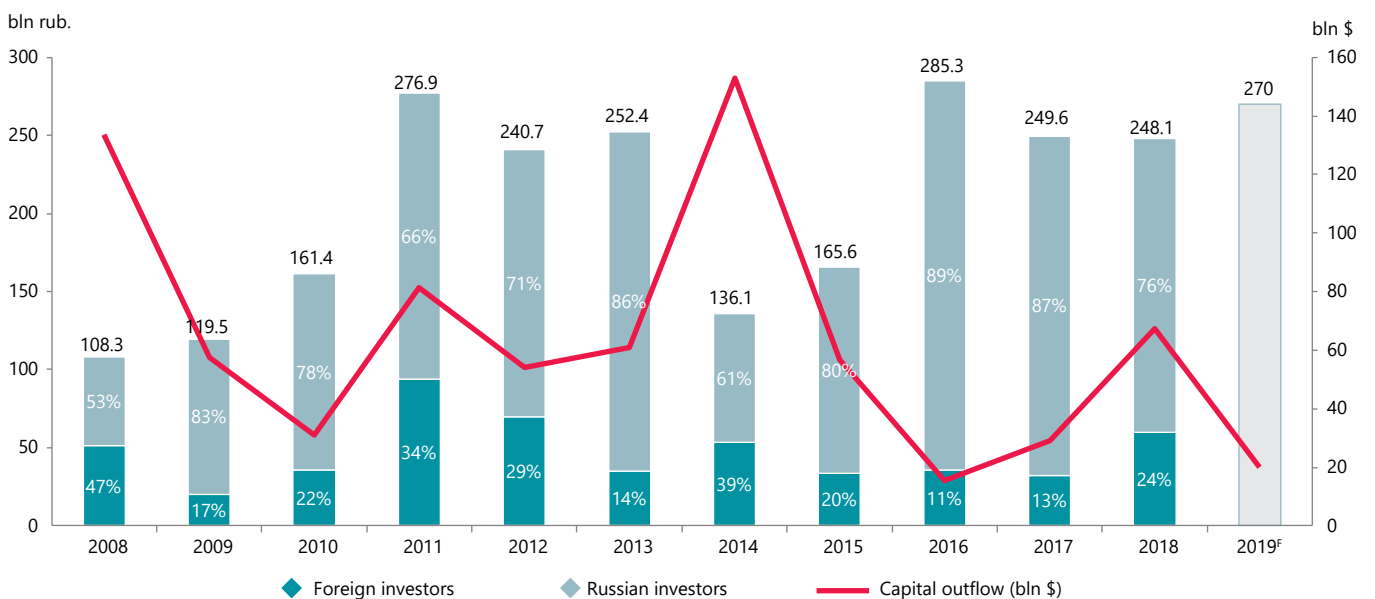
to an 'investment grade' with a positive outlook. Another rating agency, Fitch, made no amends to its prior assessment made in August, which was BBB- with a positive outlook. Therefore, according to rating agencies, the long-term foreign currency credit rating of Russia is currently at the bottom investment grade.

According to the Central Bank of Russia, the net capital outflow from the country exceeded the projected earlier figures and reached US\$67.5 billion in 2018, which is the largest amount since 2014.

As of 2018, the total volume of investment into the property of Russia amounted to 248.1 billion rubles, which is similar to last year's figure. It was the strong investment activity in Q4, which added another 135.5 billion rubles to the total volume of investments, that made it possible even despite the modest results of the first three quarters of the year. The contribution of Q4 into the total volume of investments into the property of Russia has become even more significant over the past four years. Thus, the share of Q4 amounted to 55% of all investments made into the Russian property market during 2018.

As of 2018, the sector of offices leads in the transaction structure, with its share of 117.1 billion rubles or 47% of all investments into the property market of Russia. The growth of investment into the office market amounted to 23% yoy. The purchase of an office complex within Mirax Plaza and

Investment volume in commercial real estate (bln \$) / Capital outflow (bln \$)



Source: Knight Frank Research, 2019

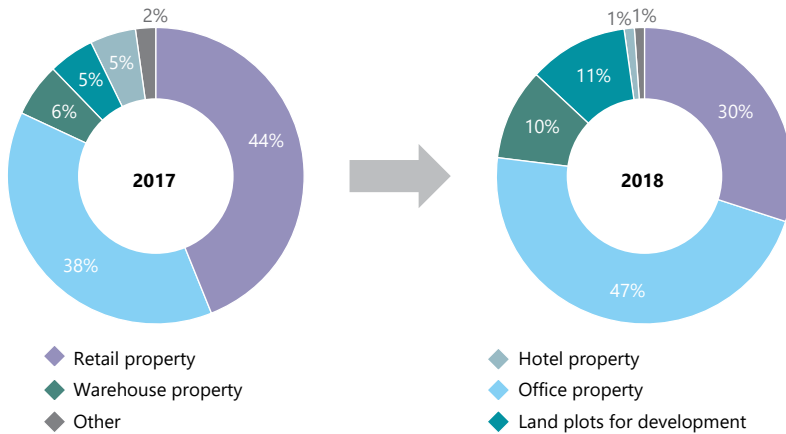
INVESTMENT MARKET

Quarterly growth of investment volume by sector



Source: Knight Frank Research, 2019

Investment structure by segments



Source: Knight Frank Research, 2019

Investment transactions volume movements by sector (compared with 2017)

Land plots for development	+102%
Warehouse property	+66%
Office property	+23%
Retail property	-31%
Hotel property	-78%

Source: Knight Frank Research, 2019

Suvorov Plaza by Sberbank made the key contribution into the leadership of the office sector. The estimate price of the property is 50 billion rubles.

The retail sector is on the second place by the volume of attracted investment, with its 74.9 billion rubles or 30% of all investments. The investment trading volume with retail properties dropped by 31% as compared to 2017.

Land plots for development are on the third place, with their share of 11% of all investments made in 2018. The volume of investments grew by 102% as compared to last year's figure, which makes it the leader among all the sectors in terms of the annual growth.

The sector of warehouses and industrial property attracted 23.7 billion rubles or 10% of all investments in 2018. The growth of the

investment volume in this sector amounted to 66%. The remaining 2% of investments are shared by hotels and other sectors of the property market.

As of 2018, the Moscow region is the leader among the other regions of Russia, with its share of 74% of all investments. The share of St. Petersburg amounts to 21%. The remaining 5% are shared by Volgograd, the Voronezh region, Kaluga, Murmansk,

Nizhny Novgorod, and Novosibirsk. The share of the investments into Russia's capital dropped from 85% to 74% yoy, while the share of St. Petersburg, on the contrary, increased from 12% to 21%.

The investor profile underwent certain changes throughout the past year. While specialized investment companies were leading in the structure of investors with their share of 32% in 2017, the banks overtook that leadership with a share of 33% in 2018. It can be explained with a number of major office deals with the participation of such banks as Sberbank, Otkrytiye, and Vneshekonombank.

Another thing that is worth mentioning is a slump in the activity of private investors. Their

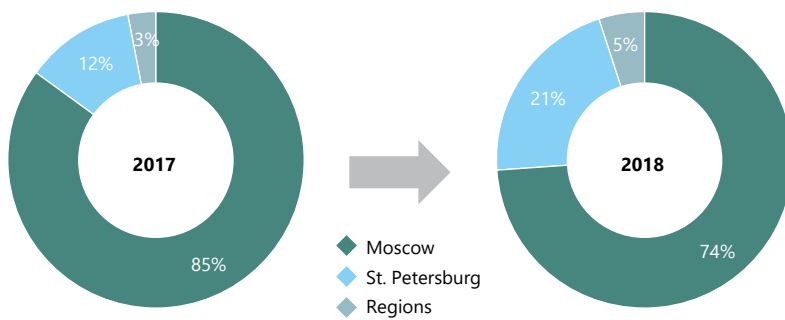
share declined by 16 percentage points to 2% of all investments as compared to 2017.

Russian investors prevail in the Russian commercial property market. The largest share of foreign investment was recorded in 2008, when this figure reached 47% of all investments made into the property of Russia. Foreign investors from such countries as Kirgizstan, the Czech Republic, France, the United Kingdom, Germany, OAE, Finland, and the USA were active in the Russian property market in 2018. The share of international investments among all the investment deals with the Russian property increased by 11 percentage points to 24%. Despite the fact that the property of Russia has higher

yields than that of Europe, it remains a risky investment option for international investors. It is mainly due to the volatility of the ruble, as well as the absence of positive signals on the part of the sanction restrictions. Therefore, the foreign investors demonstrate a reserved interest in the Russian assets.

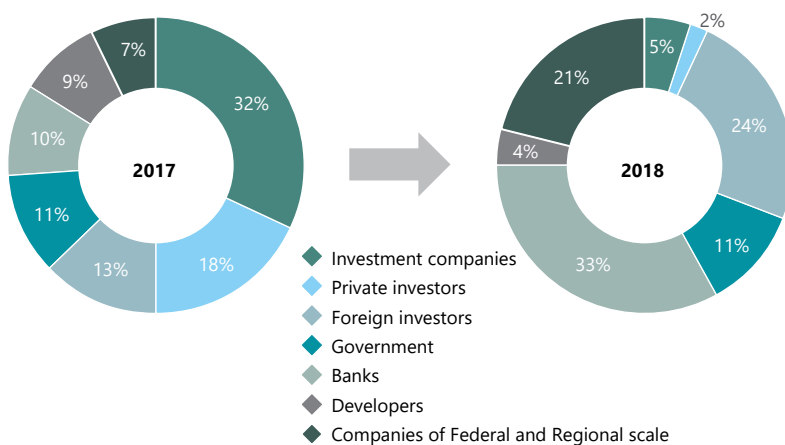
As of 2018, the cap rates stand at 9.50–10.00% for the office market, 9.75–10.25% for retail properties, and 11.50–12.00% for warehouses and industrial property. According to the Central Bank of Russia, a growth of inflation is forecast to reach 5–5.5% in 2019, which might become a driver of an insignificant growth of the cap rates.

Investment structure by regions



Source: Knight Frank Research, 2019

Investment structure by investors type



Source: Knight Frank Research, 2019

KEY TRANSACTIONS IN THE PROPERTY MARKET OF RUSSIA IN 2018

OFFICES

The purchase of a 300,000 sq m office complex within Mirax Plaza and Suvorov Plaza by Sberbank. The estimate price of the property is **50 billion rubles**.

RETAIL

The purchase of Riviera Shopping Center (298,000 sq m) by KLS Eurasia Venture Fund for **20 billion rubles**.

WAREHOUSES

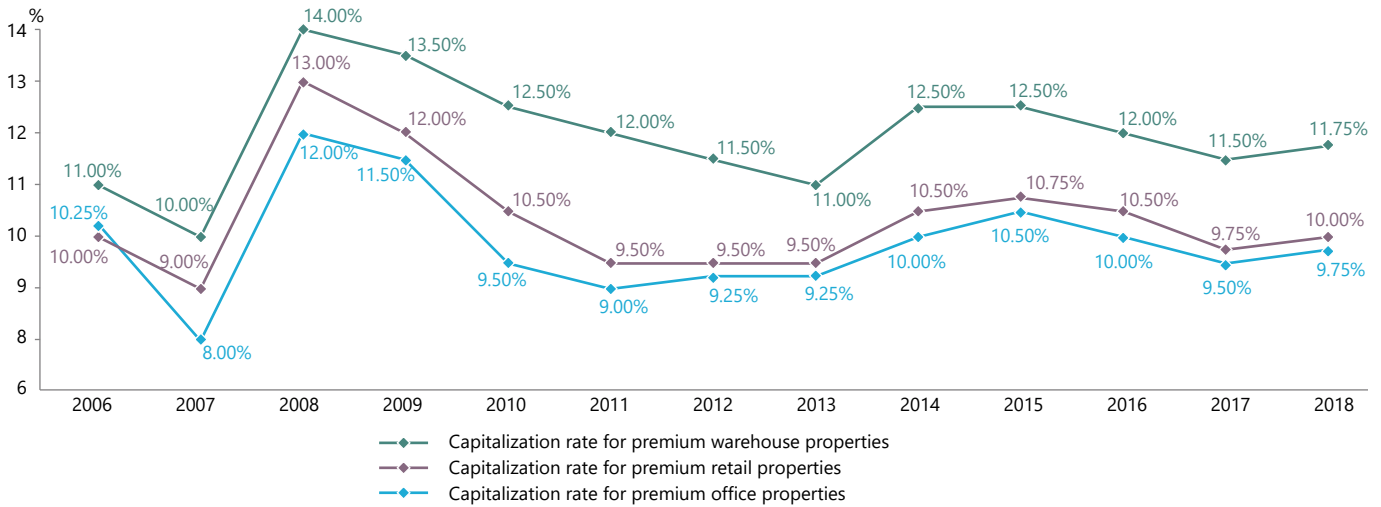
The purchase of a 50,000 sq m warehouse in Vnukovo Logistic Industrial Park by Pochta Rossii for **3.2 billion rubles**.

LAND PLOTS FOR DEVELOPMENT

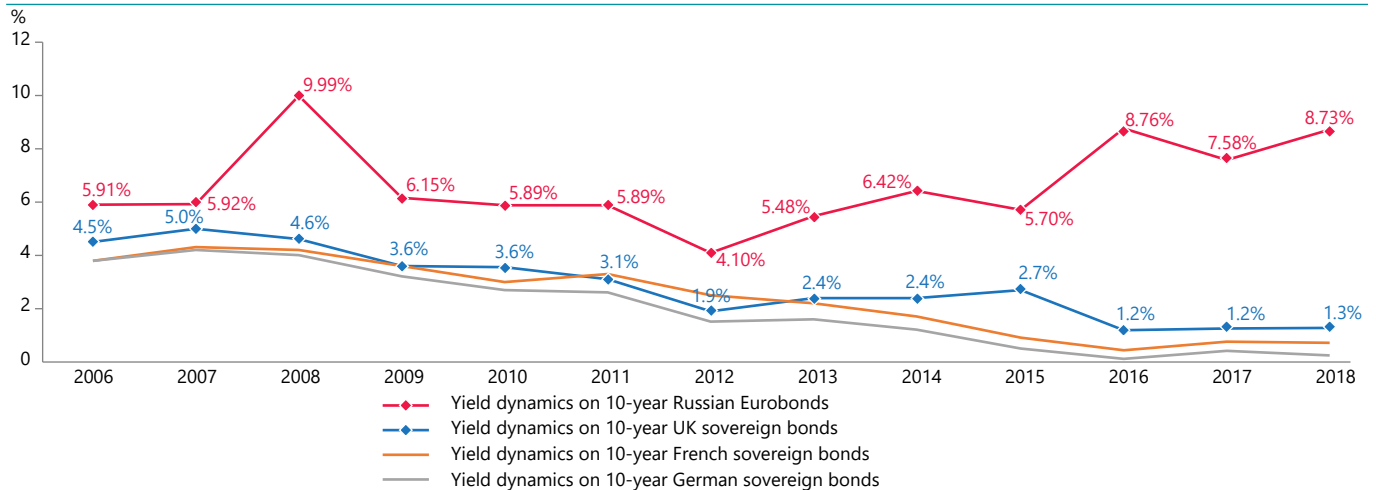
The purchase of the territory of Korston Hotel (4 hectares) by Yandex for **US\$145 million**.

INVESTMENT MARKET

Capitalization rate for premium commercial real estate properties



Yield dynamics on 10-year sovereign bonds



The following figures depict the yields dynamics of 10-year government bonds of the UK, France, Germany and Russia in currency terms, as well as the cap rate movements for prime office, retail and warehouse property in rubles (considering the current market conditions).

Source: Knight Frank Research, Investing.com, 2019

Key transactions with foreign investors

Company	Country	Property	Area, sq m
KLS Eurasia Venture Fund	Kirgizstan	Riviera Shopping Center	298,000
PPF Real Estate	Czech Republic	Nevskiy Center Shopping Mall	103,000
Leroy Merlin	France	k-rauta stores	78,000
Raven Property Group	the UK	Sever Industrial Park Volzhskiy Industrial Park	58,838 180,000
Globus	Germany	Logoprom Medvedkovo	49,500
Mubadala Investment Company	OAE	Verniy warehouse	43,000
Finnish Government	Finland	Dom Finlyandii	4,500
Hines	the USA	a share in Ducat Place II Business Center	14,300

Source: Knight Frank Research, 2019

OFFICE
REAL ESTATE

117.1 bln rub. ▲

INVESTMENT TRANSACTION VOLUME

5.9 bln rub. ▲

THE AVERAGE TRANSACTION VOLUME

9.5–10.0% ▲

CAPITALIZATION RATE

RETAIL
REAL ESTATE

74.9 bln rub. ▼

INVESTMENT TRANSACTION VOLUME

7.5 bln rub. ▼

THE AVERAGE TRANSACTION VOLUME

9.75–10.25% ▲

CAPITALIZATION RATE

WAREHOUSE
REAL ESTATE

23.7 bln rub. ▲

INVESTMENT TRANSACTION VOLUME

2.4 bln rub. ▲

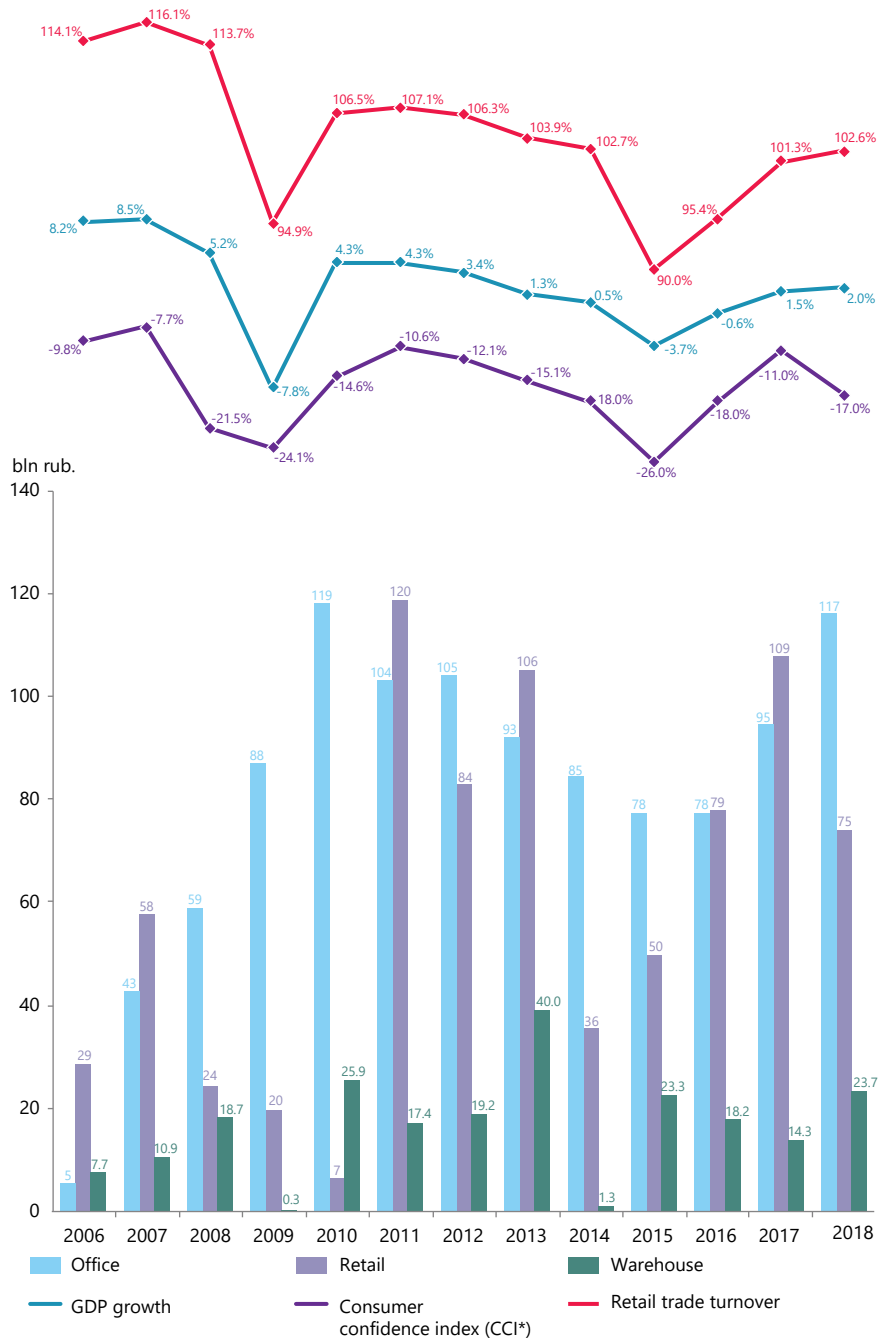
THE AVERAGE TRANSACTION VOLUME

11.0–12.0% ▲

CAPITALIZATION RATE

Change as compared with the 2017

Investment volume dynamics in real estate and GDP growth dynamics



* CCI is an indicator designed to measure consumer confidence, which is defined as the degree of optimism about the state of the economy that people express through their consumption and savings. Determined on the basis of quarterly surveys by Rosstat in all regions of Russia, CCI is the relative value of the number of positive and negative responses from the total number.

Source: Knight Frank Research, Ministry of Economic Development of the Russian Federation, 2019

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