The overall volume of investment transactions came up to $1.7 billion worth of deals changing hands in H1 2017 and exceeding H1 2016 results threefold. This figure highlights that the commercial real estate sector in Russia remains attractive to investors. The share of Q2 investment transactions is just shy of 60% of the total H1 transaction volume. At the same time, a deterrent continues to persist in the form of sanctions from the US and the European Union. In Q2 2017, Fitch agency confirmed Russia’s credit rating at the investment level of “BBB-“, stable outlook. However, the international rating agency S&P raised the outlook for Russia’s sovereign credit rating from “stable” to “positive” in March, affirming the long-term credit rating in foreign currency at “BB+” level.

H1 2017 was also marked by the key interest rate drop by 0.25 p. p. to the level of 9% per annum. At the same time, the real interest rates in Russia are among the highest in the world according to the international rating agency S&P. Besides, the Ministry of Finance announced the debut issue of sovereign bonds for 15 billion rubles and the placement of Eurobonds for $3 billion.

Office (47%) and retail (43%) segments traditionally dominate in the structure of transactions. The share of Moscow transactions in the total volume of investment transactions in Russia stayed on approximately at the same level against H1 2016, but there are prerequisites for its increase. Last year Knight Frank analysts registered a high share of transactions involving state-financed.

The investment market has been performing actively in 2017: a number of major transactions has gone through from the beginning of the year, including a landmark deal involving Chinese capital. The investment market participants have been waiting for Chinese investors since 2014, and now they have come in sight, thus, perhaps opening doors to Russia for other funds from China. As for Western investors, new players have been only conducting market monitoring – it hasn’t come yet to real negotiations and transactions. Today investors in Russia are looking for assets that generate cash flow, development projects are practically irrelevant to anyone.

“...”

Alan Baloev
Director of Capital Markets Department at Knight Frank

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

Investment volume in commercial real estate / Capital outflow

Source: The Central Bank of the Russian Federation, 2017

Source: Knight Frank Research, The Central Bank of the Russian Federation, 2017
At the moment it is unprofitable for developers to construct new commercial properties in Russia, in particular in the office and retail segments. The preconditions for such a trend appeared already in 2014, when rental rates began to drop due to the volatility of exchange rates. They even switched to ruble currency, and there was a transition from fixed rental rates to turnover rents in the retail real estate market. At the same time, the fluctuated exchange rate led to the rise of the foreign expense part of the property construction, significant boost in the cost of borrowed funds, and the increase of general construction risks. Thus, now the commercial real estate market evidences insignificant speculative supply of new facilities (both entering the market and being under construction). In particular, the main share of new office space appears mainly in multifunctional complexes that combine various segments, or in transfer hubs as part of the developers’ obligations to the authorities. New properties in the retail segment also approach the market quite infrequently and they are small. The main motive for developers to construct new shopping centres is the doubtless perspective location within the above-mentioned transfer hubs or near other large transport hubs.

companies (VTB, Transneft, RSHB, AlIZHK, etc.), the share of such transactions decreased substantially in H1 2017.

The activity of foreign investors advanced at the end of H1, as not a single transaction with their participation was recorded in Q1, but Q2 witnessed two major transactions involving foreign capital. First of all, we are talking about the purchase of Vozdvizhenka Centre by Chinese Corporation Fosun together with Russian partners, as well as the purchase of several facilities in St. Petersburg (Kellermen Centre, Premium Business Centre, Gorigo Logistic Park) by a British corporation Raven Russia. Jointly, in H1 2017 the share of foreign investment reached 15% of the total investment transaction volume.

Provided that the overall economic stabilization trend in Russia will continue and the interest to Russian commercial real estate on the part of foreign investors will also last, 2017 indicators will rise above 2016 indices to $5 bln of total transaction amount according to the forecast of Knight Frank analysts.
### Investment Market H1 2017

#### Office Real Estate
- **Investment Transaction Volume**: $800.3 mln
- **The Average Transaction Volume**: $66.7 mln
- **Capitalization Rate**: 9.75–10%

#### Retail Real Estate
- **Investment Transaction Volume**: $729.7 mln
- **The Average Transaction Volume**: $145.9 mln
- **Capitalization Rate**: 10–10.25%

#### Warehouse Real Estate
- **Investment Transaction Volume**: $32.1 mln
- **The Average Transaction Volume**: $16 mln
- **Capitalization Rate**: 11–11.5%

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*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, 2017*