56 *billion rubles - the overall Q1 2020 investment volume*

68% *of investments – development sites*

88% *the share of Moscow in total investment volume*

Knight Frank

INVESTMENT MARKET

Q1 2020

knightfrank.com/research

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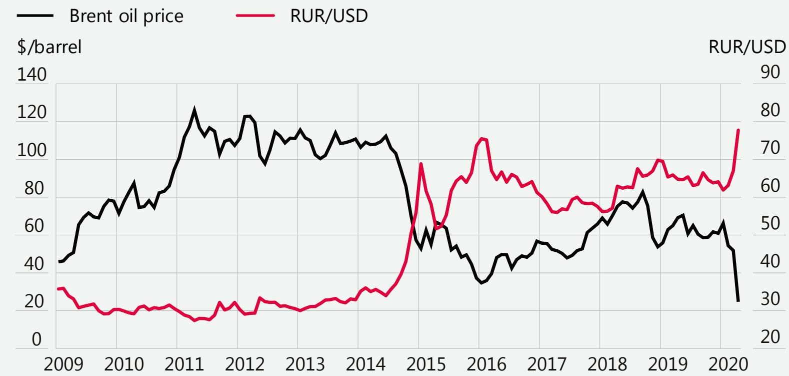
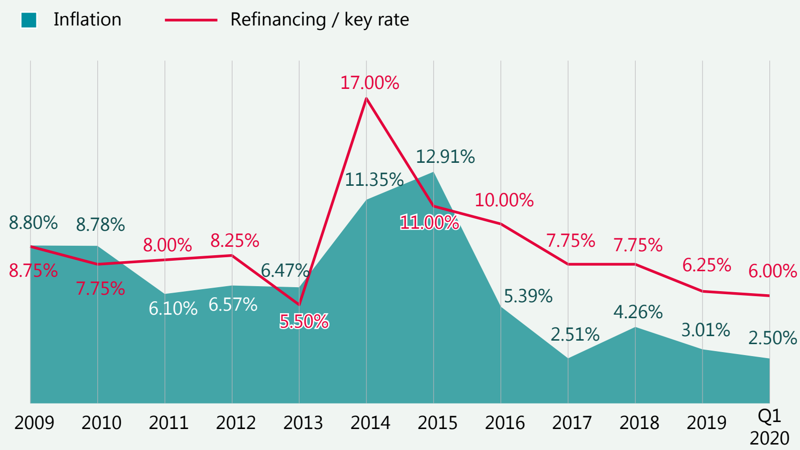
«The effects of the current economic and social situation in Russia, undoubtedly, will reach all the property markets, however any substantial structure changes of the market are not expected. The property market turned out to be better prepared for the crisis, especially after 2014. Moreover, any crisis is a unique opportunity time for strong market players, which is often impossible to grasp in a less volatile market. We are expecting a drop in the investor activity, at about 25-30% as compared to last year. The policy of the Central Bank of Russia regarding the key rate, as well as the government policy in terms of spending the federal budget and the sovereign wealth fund will play a considerable role in the stabilization of the investment activity».

Brent crude oil price and US Dollar exchange rate movements



Source: Knight Frank Research, Central Bank of the Russian Federation, 2020

The movements of inflation and the key rate of the Central Bank of Russia



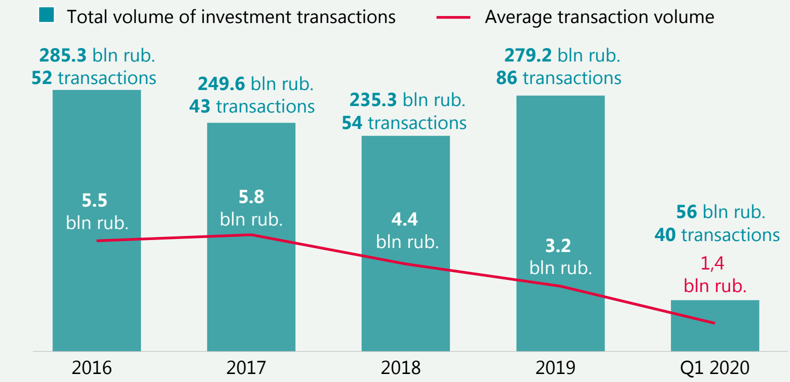
Source: Central Bank of the Russian Federation, 2020

Key findings

- As of Q1 2020, the cumulative volume of investments amounted to 56 billion rubles, which is 6% less than a year earlier.
- The land plots for development attracted the largest amount of investment (68%).
- The share of Moscow amounted to 88% of all investments, which is 13 p.p. more than in Q1 2019.

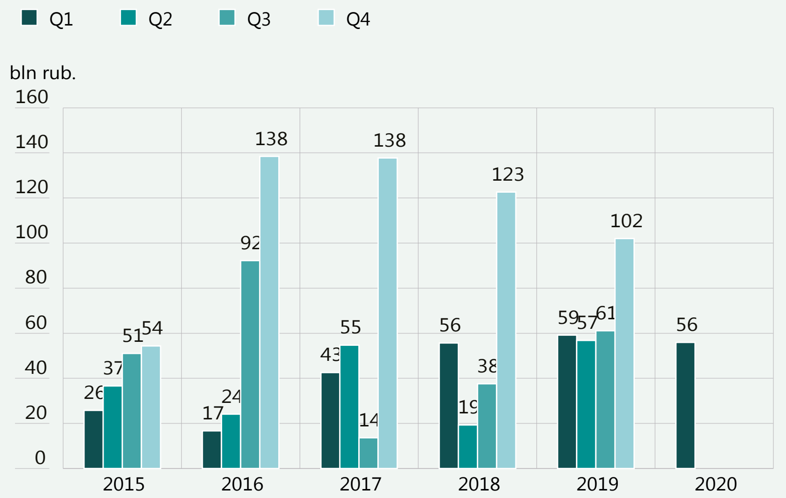
The Russian economy underwent two stresses at a time in Q1 2020; the consequences of them still remain unclear to the market players. The current condition of the market is utter uncertainty. Firstly, the decision of Russia to quit the OPEC deal contributed to the exchange rate volatility due to the collapsed oil prices. Thus, it stood at 61.9 rubles per US dollar at the beginning of the year, while the US dollar rate reached 77–79 rubles by the end of March. Despite the new deal arrangements negotiated in April, such strong exchange rate fluctuations will continue to affect the actions of the investment market players, many of which have postponed their plans to purchase or sell a real estate property. Secondly, the COVID-19 pandemic has significantly affected the social and economic conditions of this country, its impacts spreading out of the circle of immediately affected business fields to all the sectors of the property market. The officials haven't made any specific forecasts regarding the development of the economy under the circumstances of such a profound uncertainty. However, it is obvious that we will be going through a slowdown in the economic activity within the next few months, which may result in the GDP ending up in the negative zone in 2020. The current tasks of the Russian government are the slowdown in the coronavirus spread and the mitigation of the consequences of this spread. In case the situation is brought under control and the enterprises resume func-

Total investments into the commercial property of Russia



Источник: Knight Frank Research, 2020

Quarterly investments

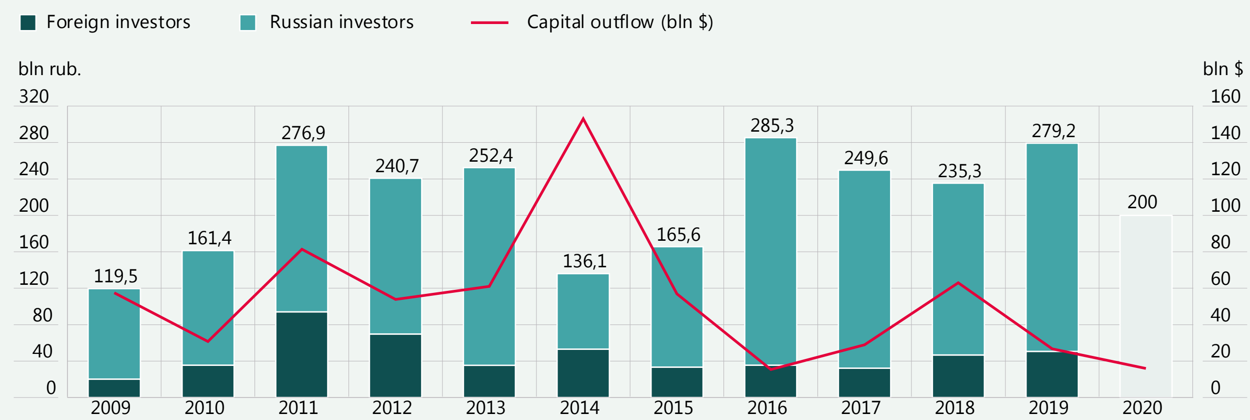


Source: Knight Frank Research, 2020

tioning before the half-quarter point of Q2, a speedy recovery of the economic activity is possible. Otherwise, the consequences may be even more considerable and severe than now. The Central Bank of Russia revised the key rate downward by 25 b.p. (to 6,00%) in order to stabilize the investment activity this year at the beginning of February. In the April the Central Bank revised the key rate again with further decline by 50 b.p. to 5.5%, the lowest level since 2014. The situation with banking project financing is still positive, the latest Central Bank decisions would have a positive impact on it. According to the leading rating agencies, the credit rating of Russia for the end of Q2 2020 remained unchanged. The estimate by S&P Global Ratings (S&P) was BBB- with stable outlook, by Moody's – Baa3 with stable outlook, and by Fitch – BBB with stable outlook as well.

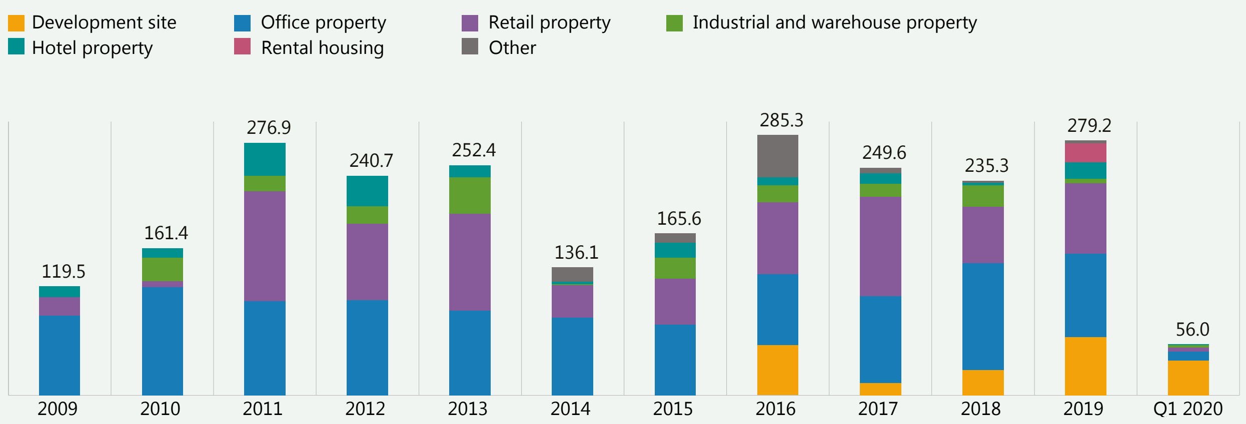
Over the first three months of the year, the investment into the property of Russia dropped by 6% to 56 billion rubles. In 2019, a growth in the volume of investments was forecast by the end of the current year, however, considering the latest economic and social situation, many investors put off purchasing the properties they had been after. The uncertainty will remain in the market throughout Q2, which will considerably slow down the pace of investment in April through to June. In its turn, as the situation will be gradually getting back to normal, it is likely for the market players to revive quickly. A rapid growth in the volume of investment is most likely to happen in Q3-Q4, including the effects of the backlog of demand.

Property investments / capital outflow



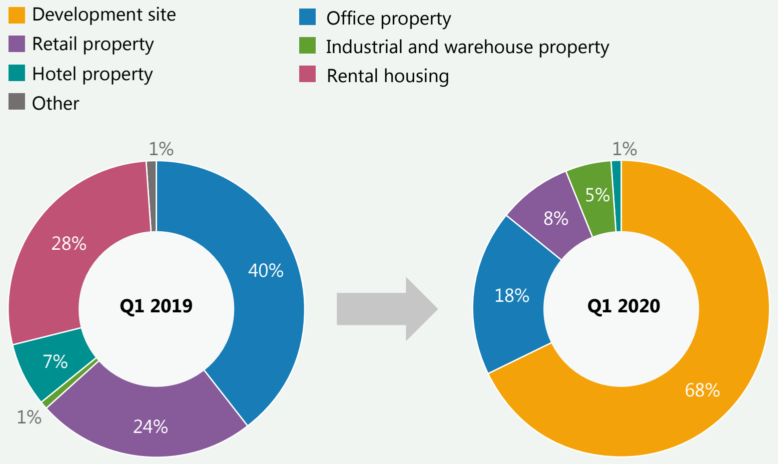
Source: Knight Frank Research, 2020

Investments into the commercial property by sector



Source: Knight Frank Research, 2020

The structure of investments into the commercial property by sector



Source: Knight Frank Research, 2020

Investment volume dynamic by segments (YoY)

Industrial and warehouse property	x10,6
Office property	-57%
Retail property	-69%
Hotel property	-82%

Источник: Knight Frank Research, 2020

Against the backdrop of the uncertainty in the economy and the real estate market, the popularity of completed properties with the investors decreased, while the land plots for development were the leading market sector, with its share of 68%. The sector remained active mainly due to the easing of the situation with the availability of financing on the part of the banks. The purchase of the land plots in Kolskaya St and Kronshtadskiy Blvd by Capital Group (5.5–6.5 billion rubles) was the largest transaction of the sector. The office property came in second in terms of the volume of attracted investment (18% of all investments). The purchase of the office premises and car spaces in Park Legend by AlphaStrakhovaniye (5.3–5.5 billion rubles) was the largest deal in the sector. Retail property came in third in Q1 2020, with its share of 8%. The purchase of Sokolniki Shopping Center by Accent Capital (2.6–2.8 billion rubles) was the largest deal of the sector. It worth mentioning that the warehouse segment turned out to be mostly steady and resistant in current market, while office and retail properties would have greater repercussions caused by crisis events.

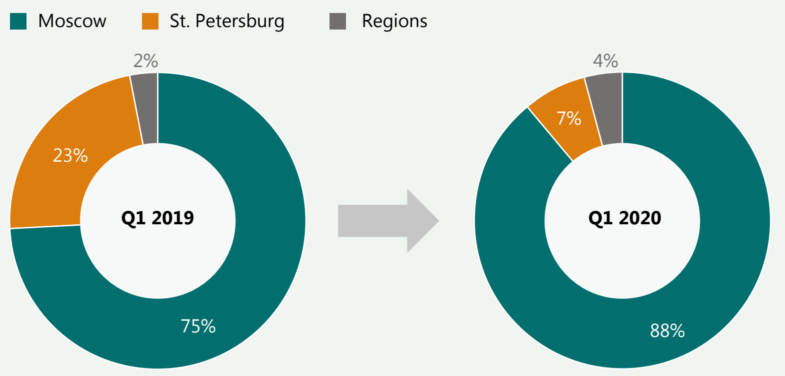
As compared to Q1 2019, the structure of demand on the part of the regional investors from all over Russia has changed. Thus, the share of Moscow has increased from 75% to 88%, as of Q1 2020. There were no significant or major deals recorded for St. Petersburg, while the share of the region in the total investment volume declined from 23% to 7%. As of 2019, the share of St. Petersburg was higher than in 2017–2018 and stood at 26%. Such a performance was due to a major deal signed in the market of St. Petersburg. Thus, a largest purchase of the year happened in the local retail market last year, namely the purchase of Galereya SC. There is no information on any major transaction under consideration in St. Petersburg this year, which means that the share of the region in the total investment volume may remain comparable to that of Q1 by the end of this year, with a small increase.

As of Q1 2020, the developers were leading the way in terms of the volume of investment, with their share of 72% in the structure of investor profile. They have been active since mid-2019, while their share amounted to 30% at the end of the year, yielding only to the investment companies. Due to the current macroeconomic situation in Russia, the demand on the part of developers is expected to decline in the coming one or two quarters. Considering the fact that the key market players have been making a lot of land purchases during last year and have accumulated a sufficient number of land plots suitable for construction, the investor activity on the part of developers is likely to decrease this year and in 2021. The share of end user deals increased considerably. Thus, the current figure went up by 11 p.p. to 15% of all investments, while it stood at 4% in Q1 2019. Investment companies were active as well, with their share amounting to 12%. The activity of the banks and the government was minimal, with their cumulative share amounting to 1%.

Russia quit the OPEC oil deal in Q1, which immediately affected the material markets and the exchange rates. The foreign investors postponed making decisions to invest into the Russian Federation, against the backdrop of the growing uncertainty. Their share of investment amounted to only 4% against 28% in Q1 2019. The foreign investment is expected to be minimal this year. Except for the exchange rate risks, the President of Russia has suggested to lay on another 15% income tax for the foreign citizens or companies, which will significantly cut the yields for the Russian property for this group of investors.

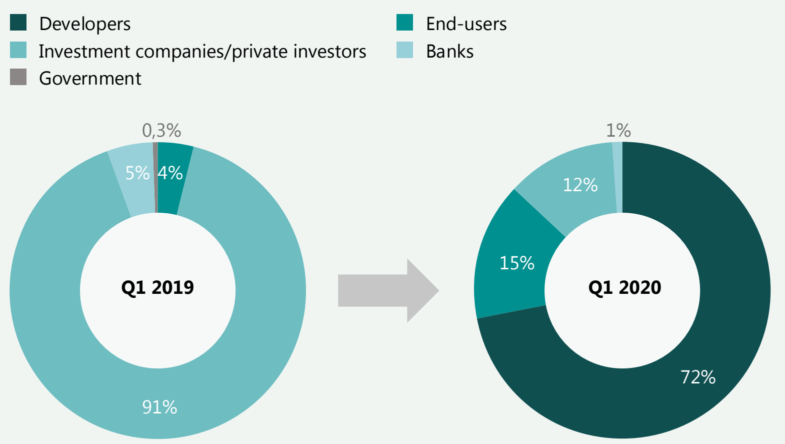
As of Q1 2020, the yields of the traditional commercial property markets amounted to 9.0–10.0% for the premium office properties, 9.5–10.5% for retail properties, and 10.75–11.75% for warehouse properties.

The structure of investments into the commercial property of Russia by region



Source: Knight Frank Research, 2020

The structure of investments into the commercial property of Russia by investor type



Source: Knight Frank Research, 2020

KEY TRANSACTIONS WITH THE RUSSIAN PROPERTY IN Q1 2020:

OFFICE PROPERTY MARKET

Alfa-Strakhovanie in Park of Legends business centre – **5.3-5.5 billion rubles.**

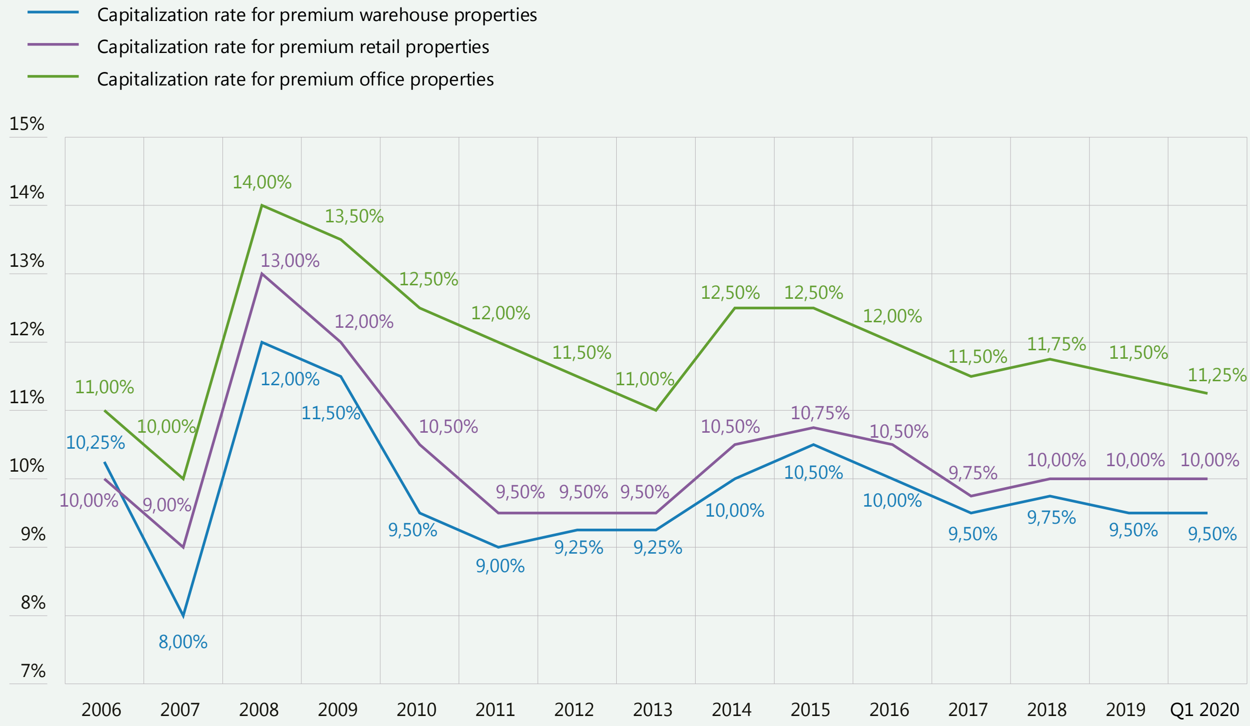
RETAIL PROPERTY MARKET

Accent Capital in Sokolniki SC – **2.6-2.8 billion rubles.**

WAREHOUSE PROPERTY MARKET

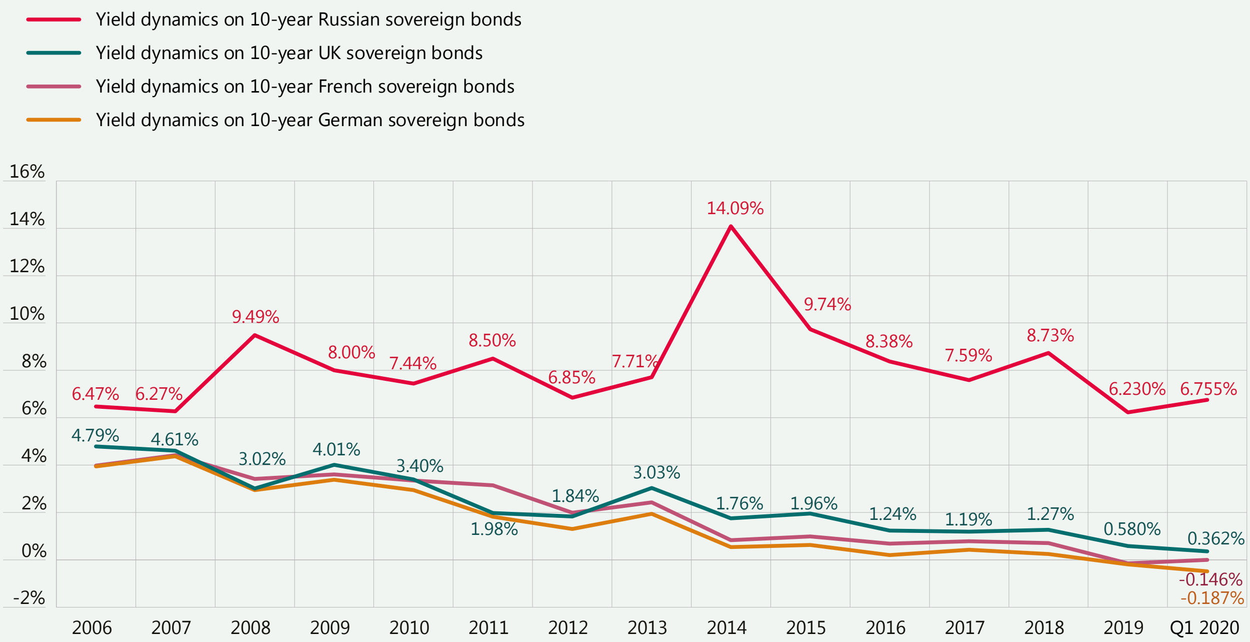
NLT and Promstroi WC in Krasnodar – **0.7–0.8 billion rubles.**

Cap rates for premium commercial properties



Source: Knight Frank Research, 2020

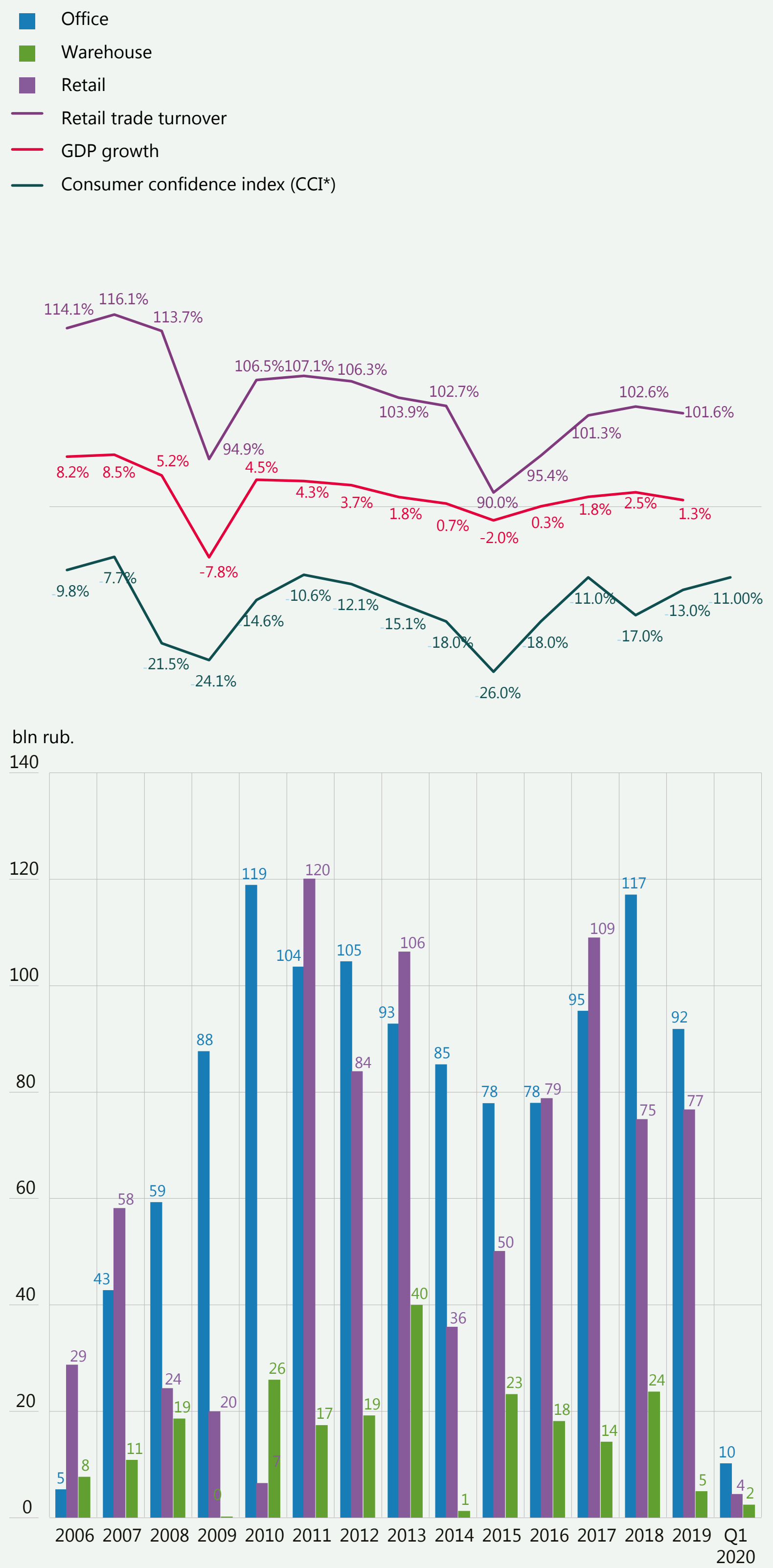
10-year bond yields



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, 2020

Macroeconomic indicator performance and investments into the commercial property



Source: Knight Frank Research, Ministry of Economic Development of the Russian Federation 2020

OFFICE PROPERTY

10.3 billion rubles

INVESTMENT TRANSACTIONS VOLUME

1.1 billion rubles

AVERAGE TRANSACTION SIZE

9.0–10.0%

CAPITALIZATION RATE

RETAIL PROPERTY

4.5 billion rubles

INVESTMENT TRANSACTIONS VOLUME

1.5 billion rubles

AVERAGE TRANSACTION SIZE

9.5–10.5%

CAPITALIZATION RATE

WAREHOUSE PROPERTY

2.5 billion rubles

INVESTMENT TRANSACTIONS VOLUME

0.4 billion rubles

AVERAGE TRANSACTION SIZE

10.75–11.75%

CAPITALIZATION RATE

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Knight Frank Capital Markets department consulted first Russian institutional CRE forward transaction

$3 BLN

the overall Russian Capital Markets department transaction volume in the last three years

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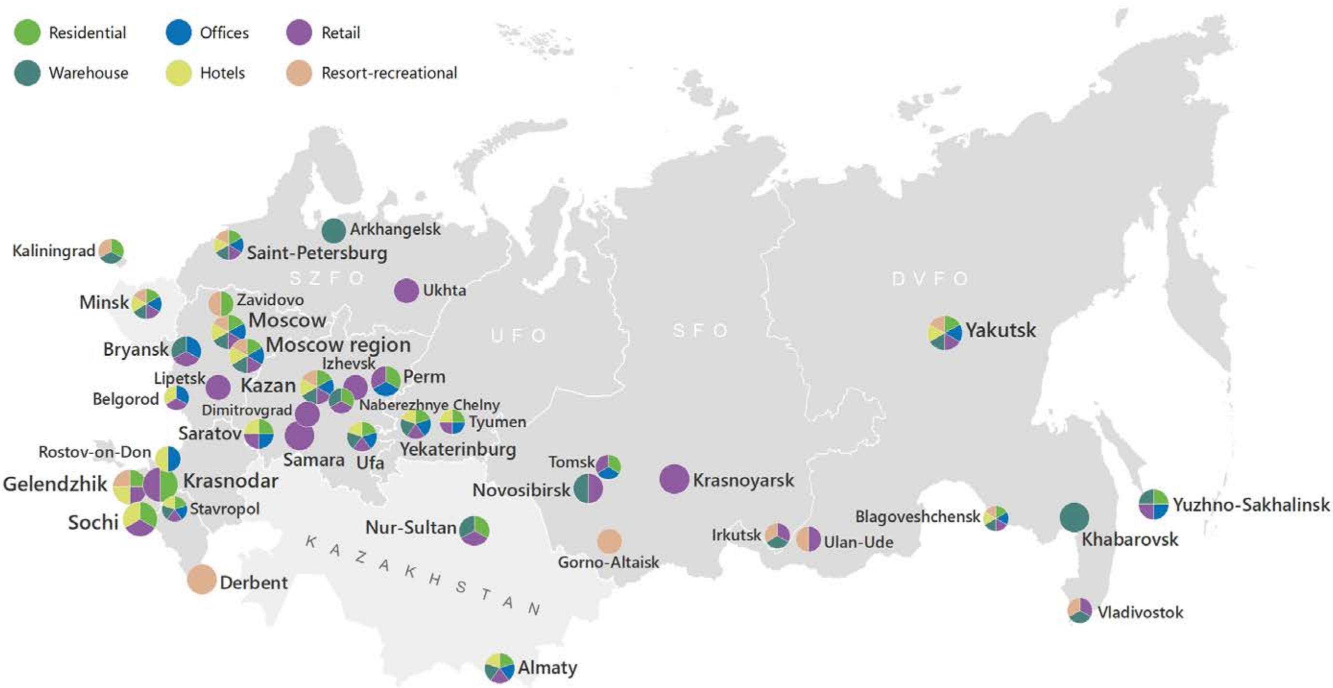

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