2/2020

25 years

AEB

REAL ESTATE MONITOR

Magazine of the Association of European Businesses

CAPITAL · OFFICE · RETAIL · WAREHOUSE · HOSPITALITY · HOUSING

Contents

Tadzio Schilling
Chief Executive Officer,
Association of European Businesses

Dear readers,

Let me kindly present the second issue of the Real Estate Monitor in 2020 to you in the capacity of new Chief Executive Officer of the Association of European Businesses.

We all have been experiencing challenging times over the last several months because of the COVID-19 pandemic. It affected health conditions of millions of people across the globe, damaged certain sectors of national economies and incurred devastating losses for small and medium-sized businesses. Inevitably, the pandemic will have long-term social, cultural and psychological implications. However, the coronacrisis will bring fresh approaches and opportunities for doing business under new circumstances.

Needless to say, the real estate sector suffered from the pandemic. The current magazine comprises data on the Moscow and St. Petersburg capital, retail, office, warehouse, hospitality and housing markets in the first quarter of 2020 – when COVID-19 just started to spread in the country and initial restricted measures were undertaken.

Because of early closures of large shopping centres, this time there is no statistical information on them in terms of supply, completions and density in Russian cities.

The coronavirus crisis produced adverse effects on the hospitality market. Occupancy dynamics of Moscow hotels showed a sharp decline in the first quarter of 2020. No new hotels opened and, apparently, openings of branded hotels announced for 2019 would be postponed till the next year.

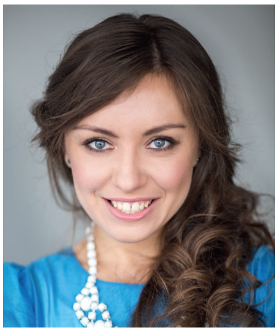
As for the residential market, the number of requests from potential tenants for high-budget rental housing dropped remarkably by the end of March (about 30% down as compared to the same period a year ago).

One of the hot topics submitted for the present magazine explores legislative amendments covering deferral and reduction of rent under high-alert or emergency regimes. The other one describes the procedure of selecting a prospective contractor (with a focus on the most common evaluation criteria) to implement a construction project.

I would like to express my profound gratitude to the contributors of the publication for providing valuable inputs. Likewise, I highly appreciate efforts invested by Real Estate Committee members into conducting uninterrupted activities. Since the introduction of the ‘stay at home’ order we managed to organize several webinars which directly addressed the impacts of COVID-19 on the real estate sector: changes in legal and tax regulations; relationships between landlords and tenants under the current circumstances; specifics of the workplace transformation right after the pandemic.

Dear friends, we have been closely monitoring the current developments to ensure a gradual and secure way out of the lockdown. Meanwhile, we keep running adjusted operations to fully sustain our mission and accomplish outlined objectives.

Please be well and take care!



Tatjana Kovalenko
Chairperson of the AEB Real Estate Committee,
Deputy General Director,
SENDLER & COMPANY

Dear readers,

The COVID-19 pandemic is now a truly global phenomenon, with more than 2.6 billion people (a third of the world's population) now living under some form of lockdown.

The short-term human and economic impact is undeniable – people are staying home, offices and shops are closed, and production has stalled. Until the threat to human life has diminished and steps have been taken to return to a fully productive economy, it is worth spending some time envisaging what this 'new normal' might look like.

Compared to elsewhere in Europe and Asia, the impact of COVID-19 in Russia was delayed. It was aggravated by a drastic reduction in oil prices and led to a significant devaluation of the Russian rouble in March 2020.

As governments make significant interventions in response to the coronavirus pandemic, businesses are rapidly adjusting to the changing needs of their people, their customers and suppliers, while simultaneously navigating financial and operational challenges.

In the real estate sector, we can see that the pandemic has accelerated some already-existing trends, whereas other trends may reverse. For example, demand for online shopping has increased and will likely continue to do so, while the ongoing trend towards increased density in work and living spaces is now under scrutiny. Shopping centres are adjusting to different consumer behaviour, offices are working to ensure increased epidemiological safety, the residential segment is slowing, and warehouses are correcting after a peak in demand. These trends differ across sectors and have various implications for real estate demand.

Crisis brings about change. Change becomes opportunity. And opportunity is the key to transformation – transformation from what we used to have into new challenges and opportunities. Life after the pandemic will not be the same as before – that is a fact. And today, it is up to us to choose which direction our businesses will take, what we will take with us, and which challenges we will transform into new opportunities.

We will focus on what really matters to us. COVID-19 is bringing us all together as we share in the human experience of dramatic change.

Events will change us for the better. Never again will we take for granted visits to our grandparents, the embrace of our friends and the smiles shared between two strangers on the street.

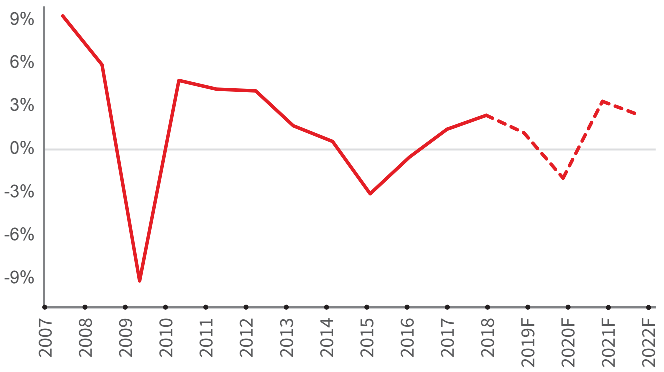
We hope you enjoy the reading and we are looking forward to seeing you at our Committee meetings!

Moscow market overview

Capital market, Q1 2020

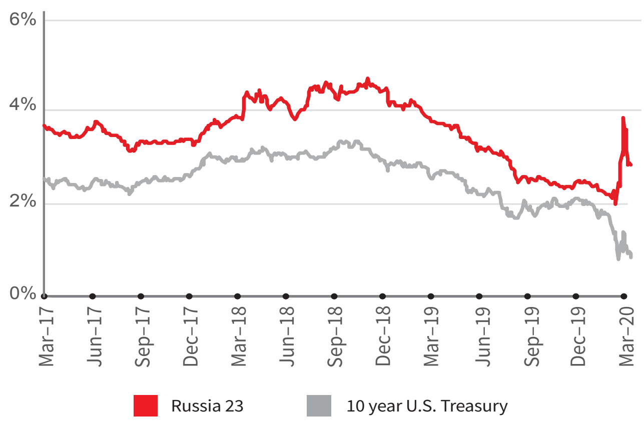
• In Q1 2020, the investment volume decreased by 13% YoY to USD 862 million.
• The residential sector (land plots for residential development) occupied the leading position in Q1 2020, accounting for 57% of the total volume. Industrial and office sectors followed, with 17% and 16% respectively.
• The share of Moscow increased to almost 77% in Q1 2020 compared to 67% in 2019. The share of St. Petersburg decreased to 20% of the country's volume in Q1 2020 from 27.5% in 2019. The share of deals closed in other regions (outside Moscow and St. Petersburg) accounted for 3%.
• As benchmarks for the market we consider Moscow prime yields between 8.5-10.0% for offices and shopping centres and 11.0-12.0% for warehouses; St. Petersburg prime yields at 9.0-11.0% for offices and shopping centres and 11.0-12.5% for warehouses. (**1–9 ▶**)

1 ▶ RUSSIA REAL GDP GROWTH



Source: Rosstat, Oxford Economics

2 ▶ SOVEREIGN BOND YIELDS

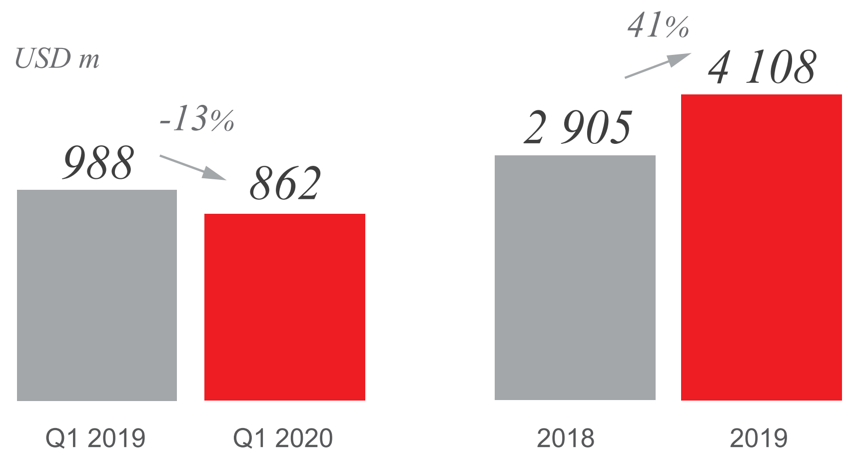


Source: Bloomberg

3 ▶ EXCHANGE RATE DYNAMICS, USD/RUB

Source: Central Bank of Russia

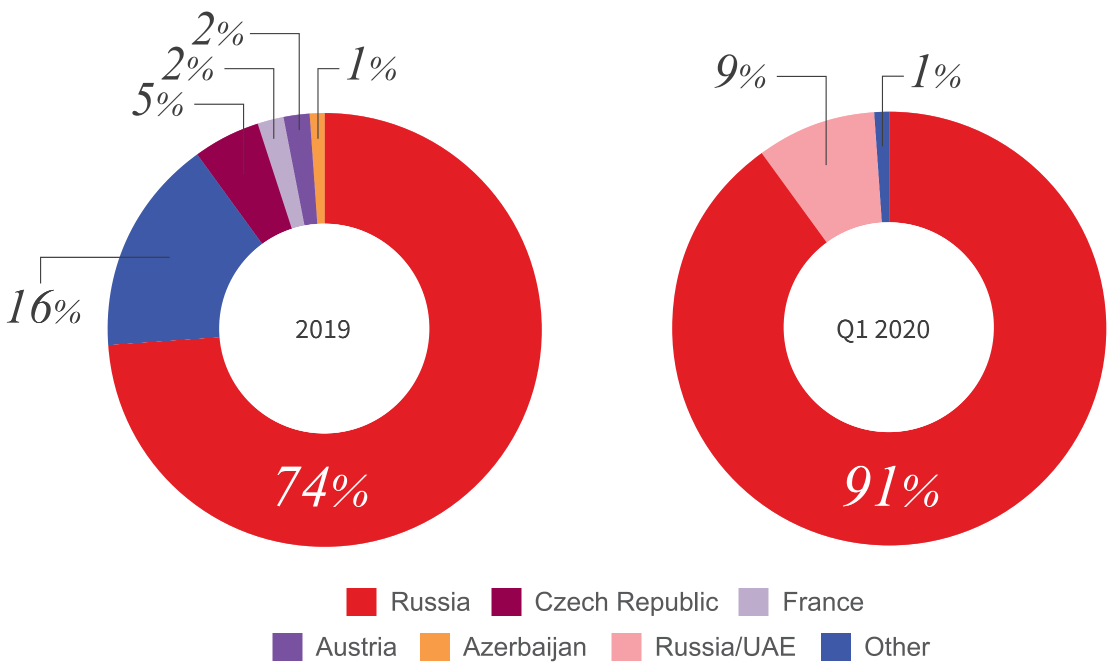
4 ▶ RUSSIA INVESTMENT VOLUME DYNAMICS*



*Investment deals excluding deals with land plots, joint ventures, sales of residential real estate to end-users.

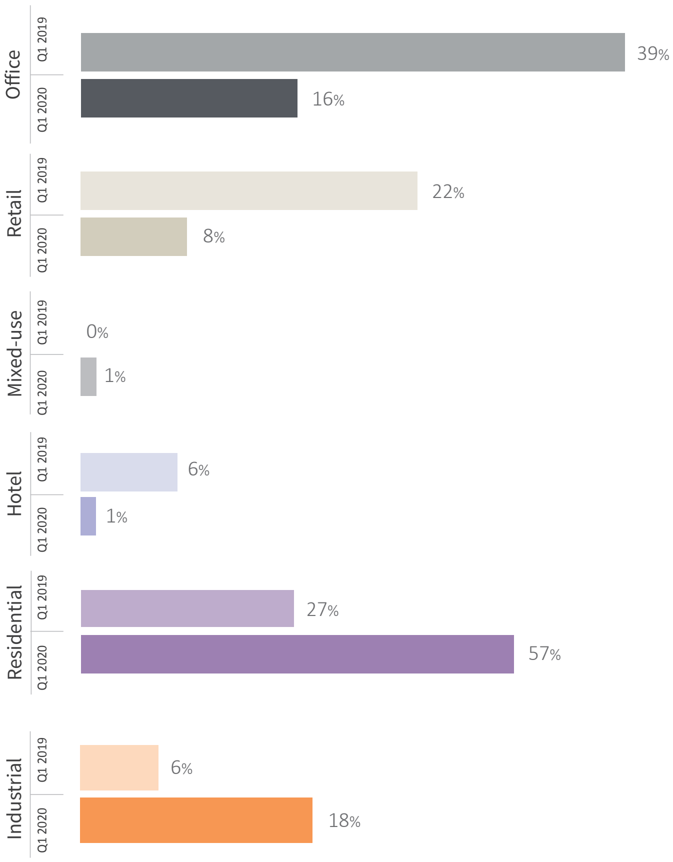
Source: JLL

5 ▶ INVESTORS BY SOURCE OF CAPITAL



Source: JLL

6 ▶ INVESTMENT VOLUME BREAKDOWN BY SECTOR



Source: JLL

7 ▶ PRIME YIELDS IN MOSCOW

Moscow

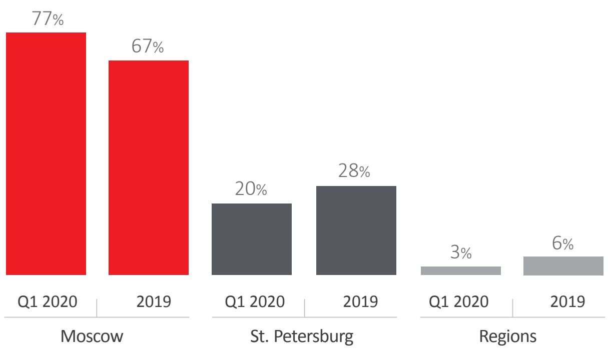
min		max
8.50%	Office	10.00%
8.50%	Shopping centre	10.00%
11.00%	Warehouse	12.00%

St. Petersburg

min		max
9.00%	Office	11.00%
9.00%	Shopping centre	11.00%
11.00%	Warehouse	12.50%

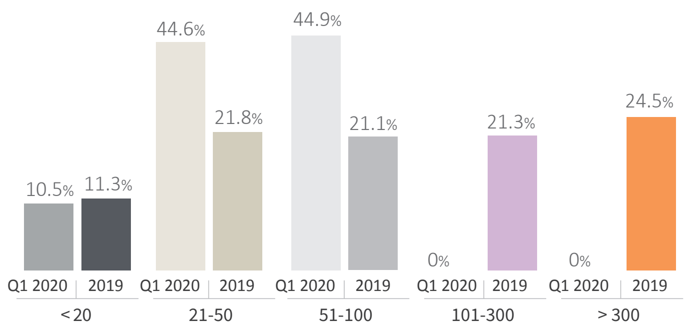
Source: JLL

8 ▶ INVESTMENT VOLUME BREAKDOWN BY REGION



Source: JLL

9 ▶ INVESTMENTS BY DEAL SIZE (VOLUME, USD M)



Source: JLL

Retail market, Q1 2020

• Compared to Q1 2019, the amount of both openings and closures went down (by 25% and 7% respectively).
• Significant decline in openings in Q1 2020 compared to 2019 is largely due to activity in the start of last year, when the number of openings and closures was above average. Adaptation of the market after the World Cup in terms of closures gives us some kind of a benchmark of indicator during a serious market transformation while in terms of openings it raises the base for the comparison.
• The overall vacancy rate in Q1 2020 went up by 0.8 ppt QoQ reaching 9.9%, but it was still lower by 0.6 ppt YoY. The vacancy rate will continue to grow and we assume that the number of vacant premises will grow by 20-30% and that will result in an increase in the vacancy rate of 2-3 ppt in Q2 2020.
• Despite the fact that retailers and foodservice operators are already experiencing a serious blow from footfall and turnover decline, average rental rates remained mainly unchanged in Q1 2020. In the future we expect a fall in rental rates. (**10–13 ▶**)

10 ▶ MOSCOW HIGH STREET INDICATORS

Prime street retail rent, RUB/sq m/year*

Q4 2019		Q1 2020
250.000	0%	250.000

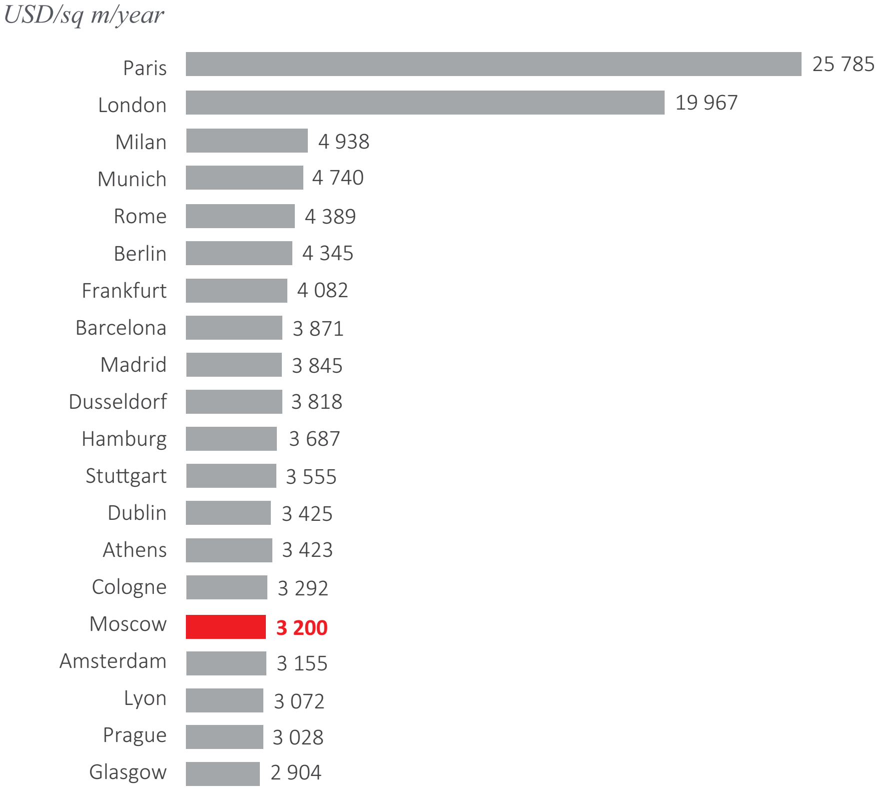
Vacancy rate

Q4 2019		Q1 2020
9.1%	80 bps	9.9%

** rents are given for rectangular form premises of 100-300 sq m with a separate entrance & a showcase on the first floor inside the Third Ring Road. For multi storey buildings & larger premises rents might be revised downwards.*

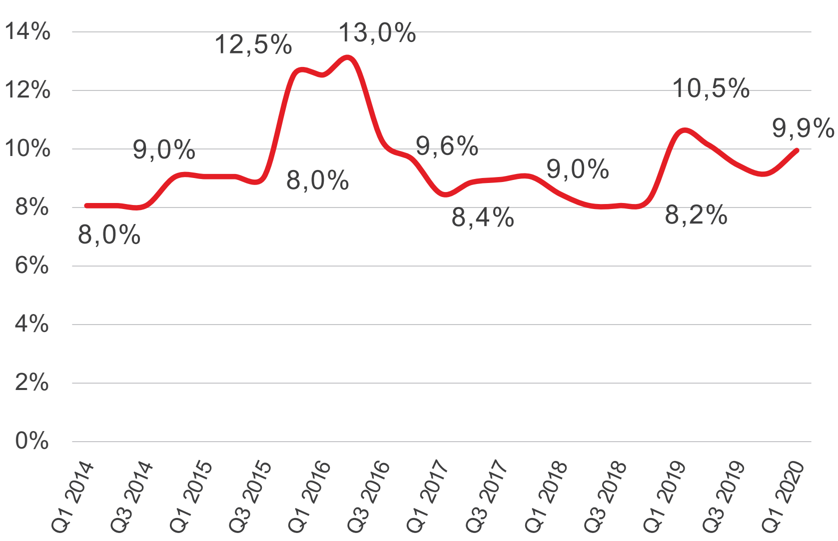
Source: JLL

11 ▶ EUROPEAN PRIME STREET RETAIL RENT INDICATORS



Source: JLL

12 ▶ OVERALL VACANCY RATE



Source: JLL

13 ▶ MOSCOW HIGH STREET RETAIL AVERAGE RENTS & VACANCY RATES (Q1 2020)

Street	Average rent (RUB/sq m/year)
Stoleshnikov	190 000
Kuznetsky Most	170 000
Nikolskaya	150 000
Petrovka	135 000
Patriarshie Prudy	120 000
Arbat	95 000
Maroseyka	95 000
Tverskaya	90 000
Novy Arbat	90 000
B. Dmitrovka	90 000
B. Nikitskaya	90 000
Myasnitskaya	85 000
Pokrovka	80 000
1st Tverskaya-Yamskaya	75 000
Pyatnitskaya	70 000
Garden Ring	60 000

Street	Vacancy rate
Nikolskaya	25,9%
B. Nikitskaya	18,9%
1st Tverskaya-Yamskaya	16,3%
Stoleshnikov Lane	14,3%
Novy Arbat	13,7%
Kuznetsky Most	12,7%
Petrovka	10,4%
Arbat	9,7%
Garden Ring	9,1%
Maroseyka	8,2%
Tverskaya	8,1%
Pyatnitskaya	7,5%
Pokrovka	7,2%
Myasnitskaya	6,5%
Patriarshie Prudy	5,8%
B. Dmitrovka	4,2%

Office market, Q1 2020

• The total completions in Q1 2020 amounted to 56,000 sq m, which is twice higher than in Q1 2019. One Class A office object, Smolenskiy Passage Phase II (15,000 sq m) and two Class B+ office objects, MFK Kvartal West (34,000 sq m) and Nagornaya St., 20/7 (7,000 sq m), were completed. The new office supply in 2020 is expected to be 245,000 sq m.

• The take-up in Q1 2020 was 29% down from the result of Q1 2019. The overall volume reached 204,000 sq m.

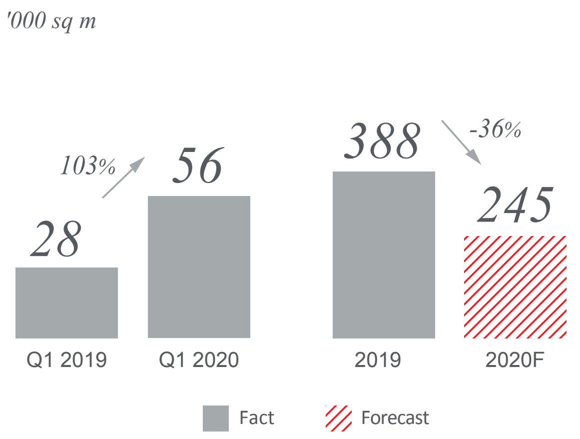
• The highest demand was outside TTR that amounted to about 56% of total take-up. Deals closed in properties located from GR to TTR and CBD reached 19% and 26% respectively.

• Business service companies occupied a leading position in the demand for Moscow offices in Q1 2020 with 31% share of total take-up volume. The second place with 26% was occupied by banking and financing companies. The third are mining and exploration organizations, which accounted for 21% of new deals.

• The overall vacancy reached 10.5%, +90 bps QoQ. During Q1, the vacancy in the zone outside TTR increased by 100 bps to 11.8%. In Class A the vacancy increased by 30 bps to 8.4%, in Class B+ by 90 bps to 10.9%. In Class B- the vacancy increased by 140 bps to 11.5%.

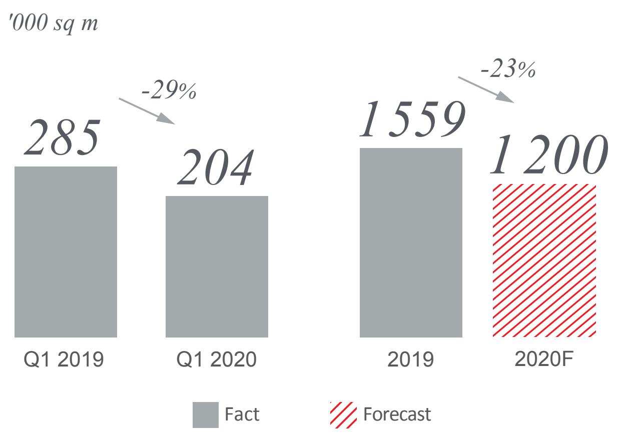
• Asking prime rental rates in Q1 2020 were at RUB 45,000-60,000/sq m/year, Class A rental rates were at RUB 25,000-45,000/sq m/year, Class B+ rents were at RUB 12,000-25,000/sq m/year. (**14–22** ▶)

14 ▶ VOLUME OF NEW SUPPLY



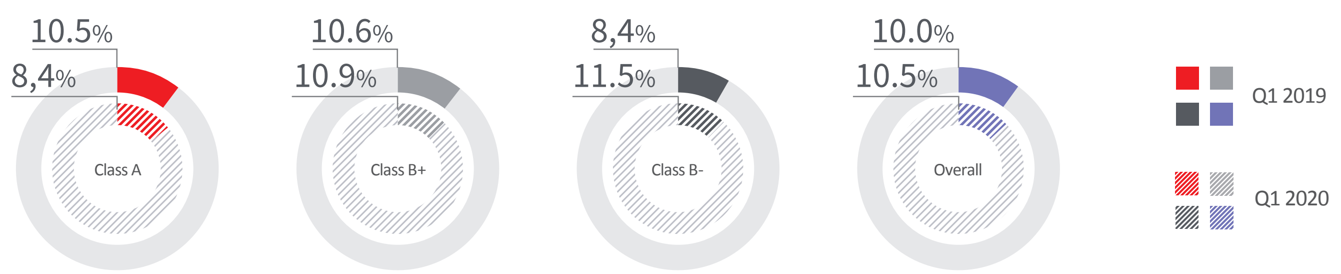
Source: JLL

15 ▶ VOLUME OF TRANSACTED SPACE



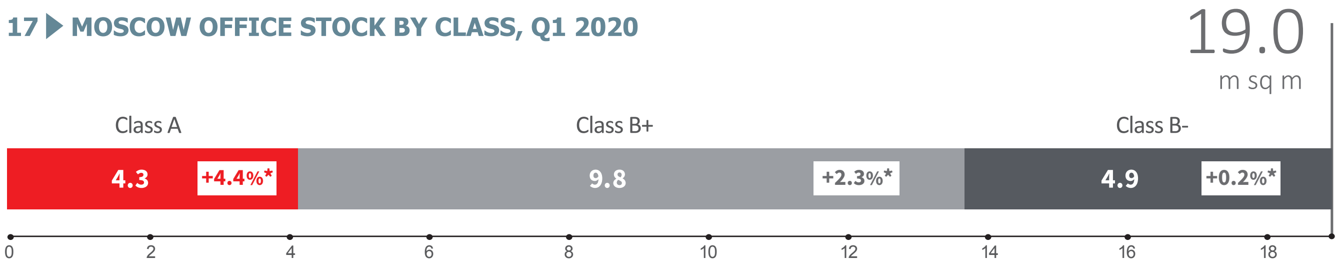
Source: JLL

16 ▶ VACANCY RATES BY CLASS



Source: JLL

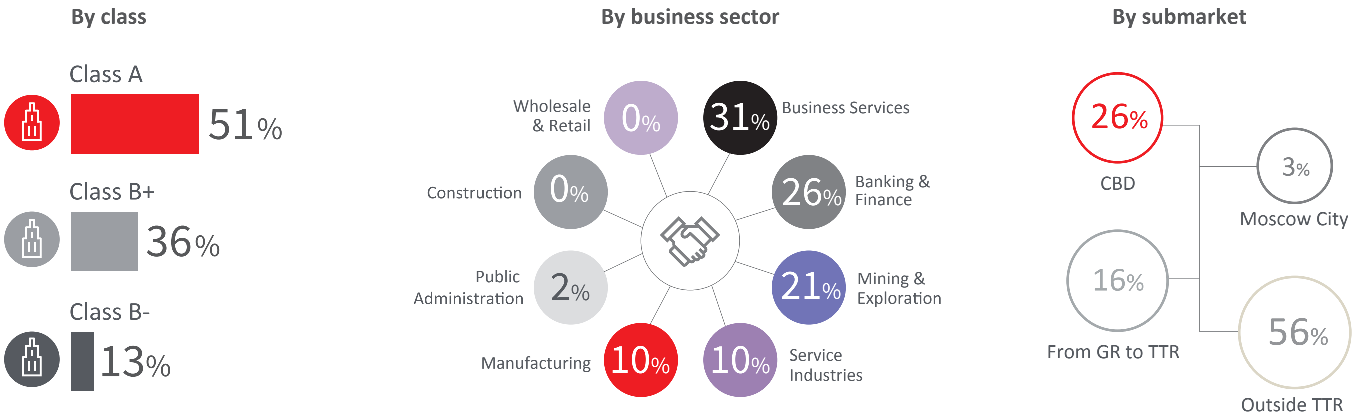
17 ▶ MOSCOW OFFICE STOCK BY CLASS, Q1 2020



*Growth QoQ

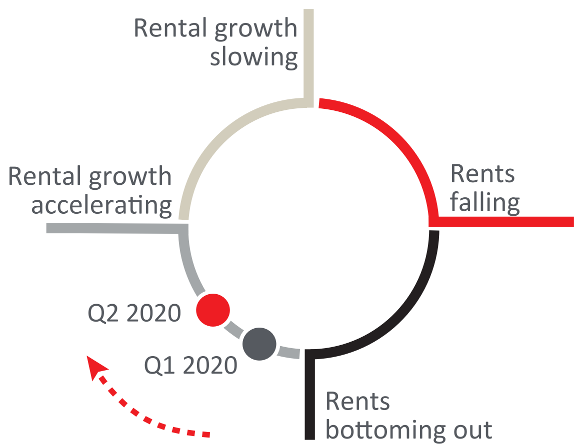
Source: JLL

18 ▶ TRANSACTED SPACE BY CLASS, SECTOR AND LOCATION, Q1 2020

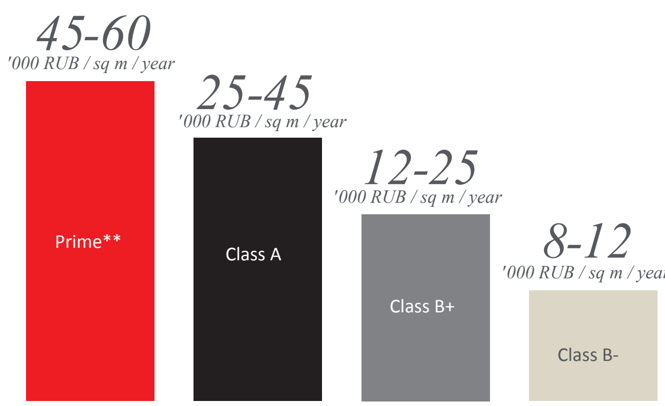


Source: JLL

19 ▶ OFFICE PROPERTY CYCLE IN MOSCOW



20 ▶ ASKING RENTS*



*Asking rents (including pre-lets) exclude VAT.

**Prime rents refer to rents in high quality buildings in the Central Business District (CBD).

Source: JLL

21 ▶ MOSCOW OFFICE SUBMARKETS, 2019

	CBD*	Moscow City	From GR to TTR**	Outside TTR***
Stock, sq m	4,060,779	1,157,941	5,709,086	9,311,961
Availability, sq m	338,436	64,954	561,766	1,098,022
Vacancy rate, %	8.3	5.6	9.8	11.8
Transacted space, sq m	51,907	6,073	38,408	113,207

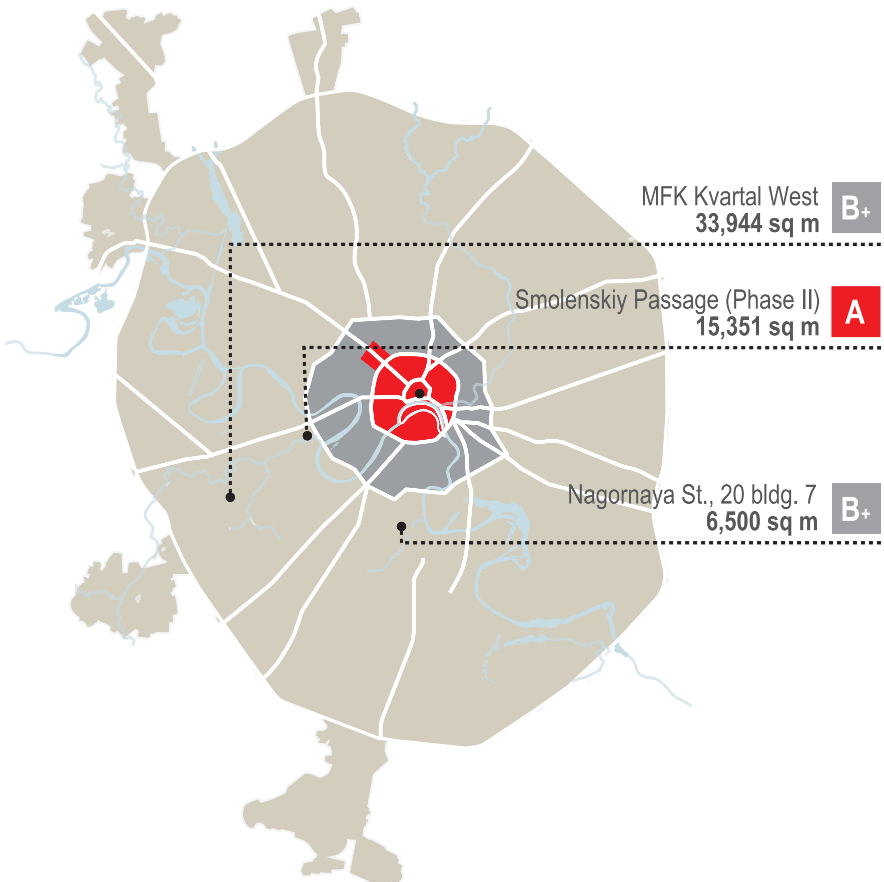
*The Central Business District (CBD) submarket comprises the area within and in close proximity to the Garden Ring (GR) and Tverskaya-Yamskaya Street.

** Excludes Moscow City.

*** Including outside MKAD projects.

Source: JLL

22 ▶ KEY NEW SUPPLY IN Q1 2020



Source: JLL

Warehouse market

Over the past few years, online retail has been increasing its impact on the warehouse sector. Self-isolation and high-demand for online purchases made it obvious that the segment has issues with the scaling of business and turnaround time for orders. This will lead to increasing demand for warehouse space from retailers and will stimulate development of urban logistics.

Nowadays retail is the most affected sector of commercial real estate as it is the most sensitive to the lockdown and economic recession. There is an opportunity to transform vacant areas of shopping centres into spaces for urban logistic such as 'click & collect' points, or spaces for dark kitchens or buffer storage.

Nowadays the market players are focusing on safety of warehouse workspace after lifting the restrictive measures.

The pandemic and economic recession will determine key development trends of the warehouse segment in the mid-term and long-term perspectives.

23 ▶ NEW CONSTRUCTION, AVERAGE RENTAL AND VACANCY RATES

560,000 sq. m -55%*
New construction
2020F

2.8 % 0%*
Vacancy rate
Forecast for December 2020

4,000 RUB / sq. m annum -2,4%*
Average rental rate
Forecast for December 2020

* % change from the last forecast of 01.01.2020

Source: Cushman & Wakefield

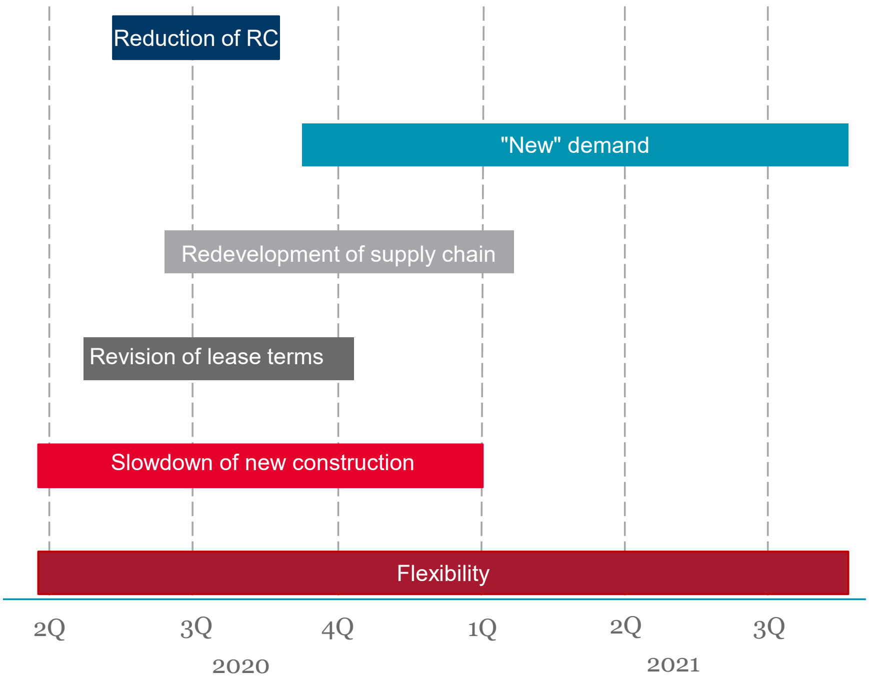
Despite ongoing restrictions, buying and leasing activity is recovering. We note growth of business activity of logistic companies in addition to high demand from food and online retailers and increasing demand for industrial areas with necessary utilities.

During the lockdown, 10% of warehouses in the Moscow region are temporary closed. Some tenants, basically international companies, also suspended work for safety reasons.

Landlords hold off on negotiations with tenants about temporary optimization of lease terms. Success of negotiations depends on tenant risk profile.

Ongoing long-term projects are still active despite the current market condition.

24 ▶ TRENDS FORECAST



Trend	Comment
Flexibility	Strategies for adaptation and return to business activity. Flexibility of business processes for any market changes.
Slowdown of new construction	New construction is expected to be lower than was forecasted at the beginning of the year.
Revision of lease terms	The short-term revision and optimization of lease terms.
Revision of supply chain	Revision of supply chains by some tenants (for instance, to minimize dependence on suppliers from Asia).
"New" demand	Demand recovery from other business sectors, additionally to food and online retailers.
Reduction of rent collection	Temporary reduction of rent collection.

Source: Cushman & Wakefield

Hospitality market

The upscale segment demonstrated a positive trend in rouble average daily rate (ADR) compared to Q1 2019 and showed a 5% increase (RUB 13,556). Rouble revenue per available room (RevPAR) showed a decrease – 19% and comprised RUB 6,281. US dollar figures of ADR remained unchanged and comprised USD 196, however US dollar RevPar dropped by 21% (USD 93). The overall occupancy decreased by 13% in Q1 2020 (49%).

Business hotels showed the following results in January – March 2020: US dollar RevPAR decreased by 20% (USD 49) which was composed of an 11% occupancy decrease (61%) and a 9% drop of ADR nominated in US dollars (USD 78). The rouble RevPAR decreased by 18% (RUB 3,321) and ADR dropped by 5% (RUB 5,376).

A drop of indicators was observed in the midscale segment. ADR and RevPAR nominated in roubles decreased by 3% and 20% respectively amounting to RUB 3,530 and RUB 1,953. The US dollar ADR dropped by 7% (USD 51) so as RevPAR which decreased by 22% (USD 29). Overall occupancy fell by 12% (55%).

Economy segment of Moscow hotels which is mostly represented by Soviet-era objects showed ADR in the amount of RUB 2,469 in Q1 2020 (13% increase as compared to 2019). Occupancy demonstrated 19% drop (41%) resulting in 22% decrease of RevPAR – RUB 1,006. ADR in US dollar equivalent increased by 7% and comprised USD 36. RevPAR amounted to USD 15 which is 24% lower comparing to the corresponding period of 2019.

Average occupancy across all market segments of Moscow hotels showed a decrease – 14% and comprised 51%. During Q1 2020 US dollar ADR decreased by 3% (USD 90). At the same time, ADR nominated in roubles increased by 2%, and amounted to RUB 6,233. US dollar RevPAR and RevPAR nominated in roubles decreased by 21% and 19% respectively amounting to USD 47 and RUB 3,140.

Comparing the results of Q1 2020 to the same period of the previous year we can observe a significant decrease of both rouble and US dollars figures, that was caused by the following facts:

- overall influence of COVID-19 and respective restrictive measures taken in Russia and in other major countries to prevent it in advance resulted in a sharp fall of tourist flows, which significantly affected the hotels' occupancy;
- the US dollar/rouble exchange rate raised by 6% in January – March 2020 comparing with the corresponding period of 2019. This fact explains a notable drop of indicators nominated in US dollars in line with a slight decrease of roubles figures.

An absolute gap in RevPAR between market segments demonstrated the following results:

- the gap between the upscale and midscale segments comprised USD 64/RUB 4,328 compared to USD 81/RUB 5,318 in the same period of 2018;
- the difference in RevPAR between upscale and business hotels slightly changed to USD 44/RUB 2,960 vs. Q1 2019 results (USD 56/RUB 3,701).

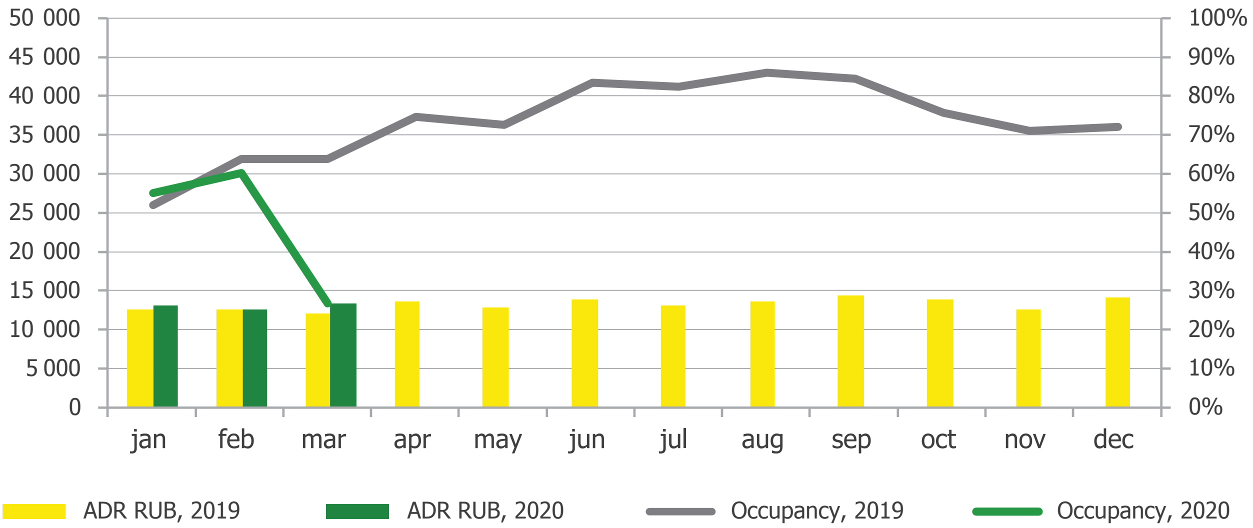
No new hotels opened during the 1st quarter of 2020. The following branded hotels were announced to be open in 2020 but taking into account the current situation with COVID-19 development we expect that these openings may be postponed till the next year. (**25-31** ▶)

25 ▶ FUTURE BRANDED HOTELS ANNOUNCED FOR OPENING IN MOSCOW IN 2020

Name	Number of rooms	Address
Crowne Plaza Moscow – Park Huaming	340	Vilgelma Pika Street, 14
Four Points by Sheraton Moscow Vnukovo Airport	250	Vnukovskaya Bolshaya Street, 8
Hampton by Hilton Rogozhsky Val	147	Rogozhsky Val Street, 12
Marriott Imperial Hotel	268	Krasnoprudnaya Street, 12, bldg. 1
Mövenpick Moscow Taganskaya	156	Zemlyanoy Val Street, 70, bld. 1
Vertical BW Signature Collection	83	Malye Kamenschiki Street, 16
Total: 6 hotels	**1244 rooms**	

Sources: EY database, open sources, operators' data

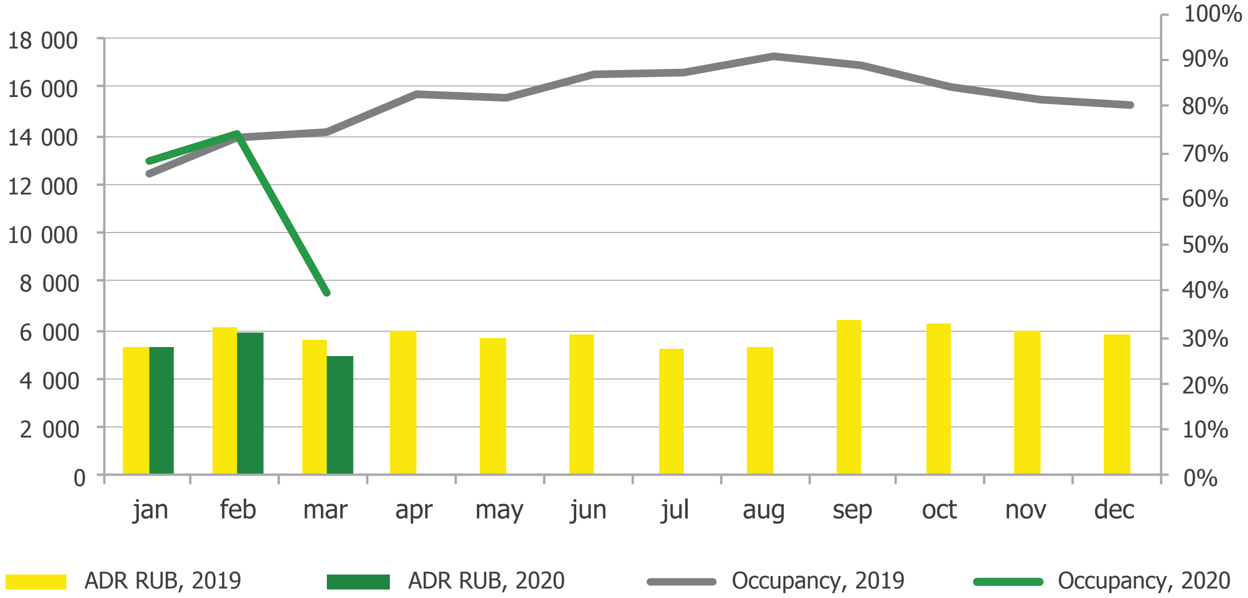
26 ▶ 5-STAR HOTELS: ADR* (RUB) AND OCCUPANCY DYNAMICS, 2020 VS. 2019



* Average daily rate

Source: EY analysis

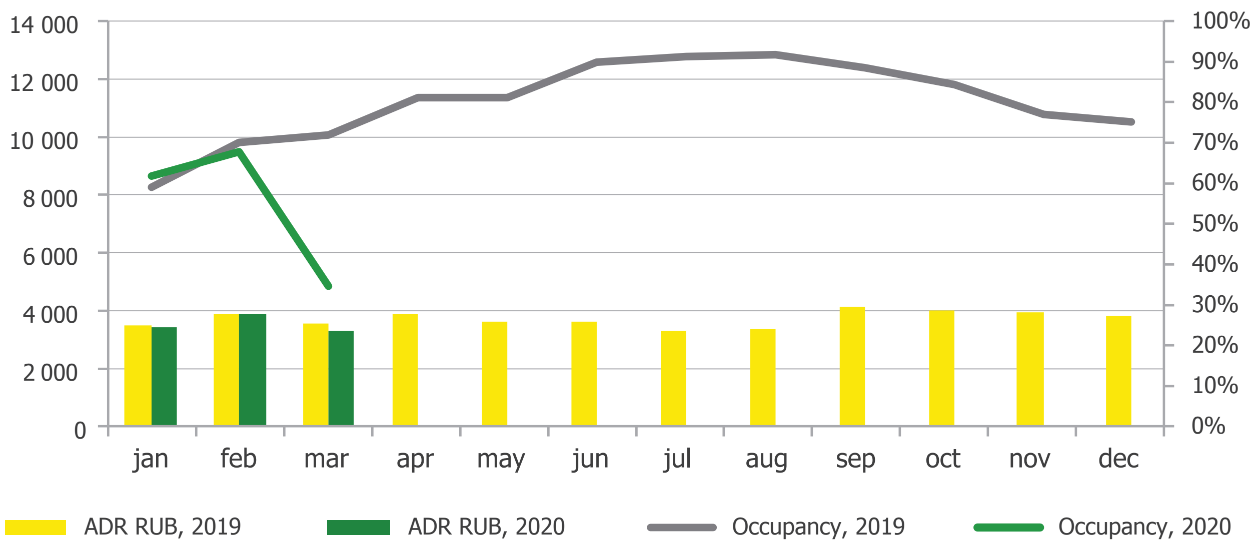
27 ▶ 4-STAR HOTELS: ADR* (RUB) AND OCCUPANCY DYNAMICS, 2020 VS. 2019



* Average daily rate

Source: EY analysis

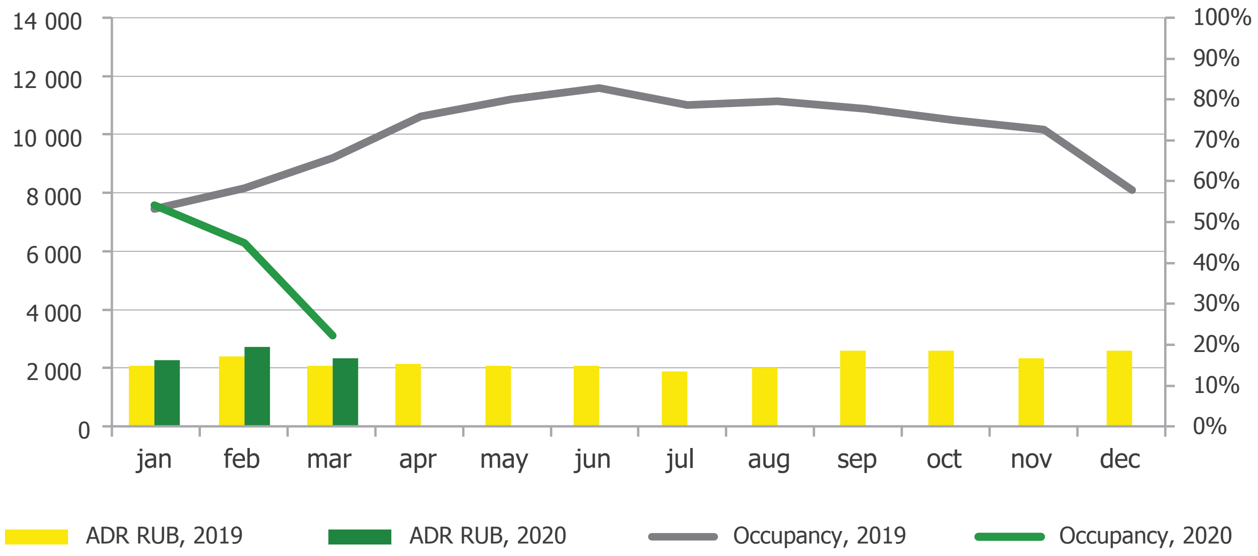
28 ▶ 3-STAR HOTELS: ADR* (RUB) AND OCCUPANCY DYNAMICS, 2020 VS. 2019



* Average daily rate

Source: EY analysis

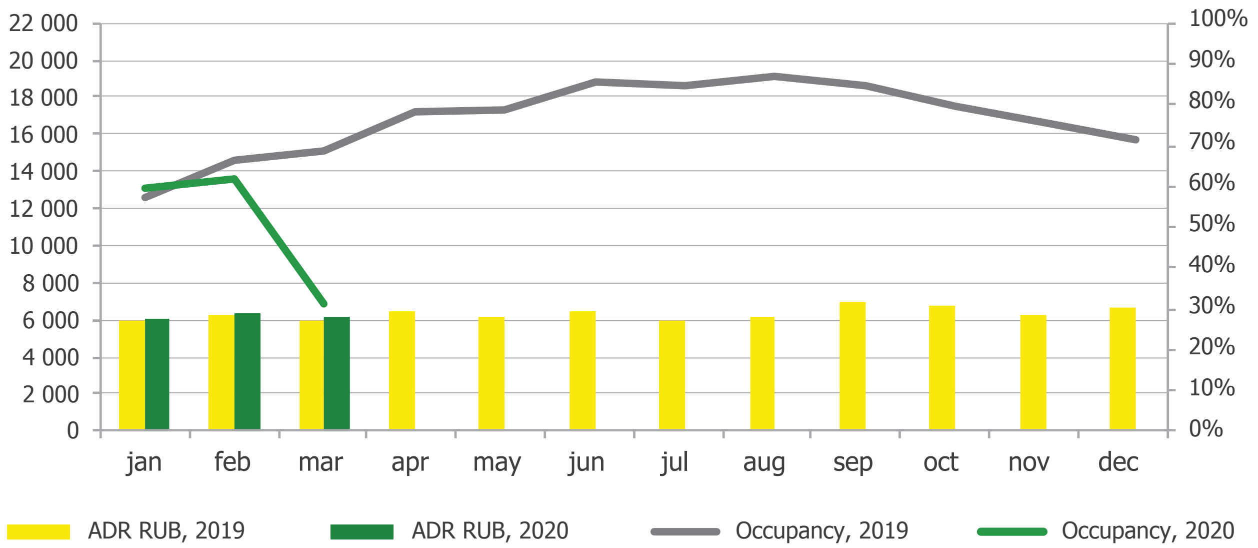
29 ▶ 2-STAR HOTELS: ADR* (RUB) AND OCCUPANCY DYNAMICS, 2020 VS. 2019



* Average daily rate

Source: EY analysis

30 ▶ AVERAGE MARKET ADR* (RUB) AND OCCUPANCY DYNAMICS, 2020 VS. 2019



* Average daily rate

Source: EY analysis

31 ▶ OPERATIONAL INDICES DYNAMICS

	January – March 2020 (USD/RUB)	January – March 2019 (USD/RUB)	January – March 2020/January – March 2019, %	2019 (USD/RUB)
5 stars				
Occupancy	49%	62%	-13%	76%
Average daily rate (ADR)	196/13,556	196/12,924	0/5	214/13,808
Revenue per available room (RevPAR)	93/6,281	118/7,753	-21/-19	161/10,352
4 stars				
Occupancy	61%	71%	-11%	82%
ADR	78/5,376	86/5,670	-9/-5	89/5,774
RevPAR	49/3,321	62/4,052	-20/-18	73/4,720
3 stars				
Occupancy	55%	67%	-12%	80%
ADR	51/3,530	55/3,634	-7/-3	57/3,703
RevPAR	29/1,953	37/2,434	-22/-20	46/2,960
2 stars				
Occupancy	41%	59%	-19%	72%
ADR	36/2,469	33/2,186	7/13	35/2,257
RevPAR	15/1,006	20/1,298	-24/-22	25/1,613
Average				
Occupancy	51%	65%	-14%	77%
ADR	90/6,233	93/6,103	-3/2	99/6,385
RevPAR	47/3,140	59/3,884	-21/-19	76/4,911

Source: Smith Travel Research, EY analysis and forecast

Housing market

In March 2020, the number of requests for high-budget apartment rental in Moscow decreased by almost a third, and the supply volume significantly exceeded current demand. This is not surprising, as in the current adverse conditions, potential tenants are not prepared to enter into transactions, and moving to new housing has been postponed. With the improvement of the situation, such a sharp decline in tenant activity could in the future significantly affect the development of the market in the form of deferred demand, as projected at the end of the third quarter.

DEMAND

The current situation has led to changes in demand in the Moscow high-budget rental market. Despite the fact that the number of requests from tenants in January and February 2020 remained consistent compared with the previous year, in March the number of requests from customers decreased significantly.

There was a decrease in demand of up to 30% compared to the previous year (March 2020/March 2019). Correction for the entire first quarter was 13% compared to the previous year (January – March 2020 and January – March 2019). In fact, demand has returned to 2018 values. As such, the number of requests from potential tenants in the first quarter of 2020 only slightly exceeds the level of demand for the same period in 2018 (January – March 2020 and January – March 2018).

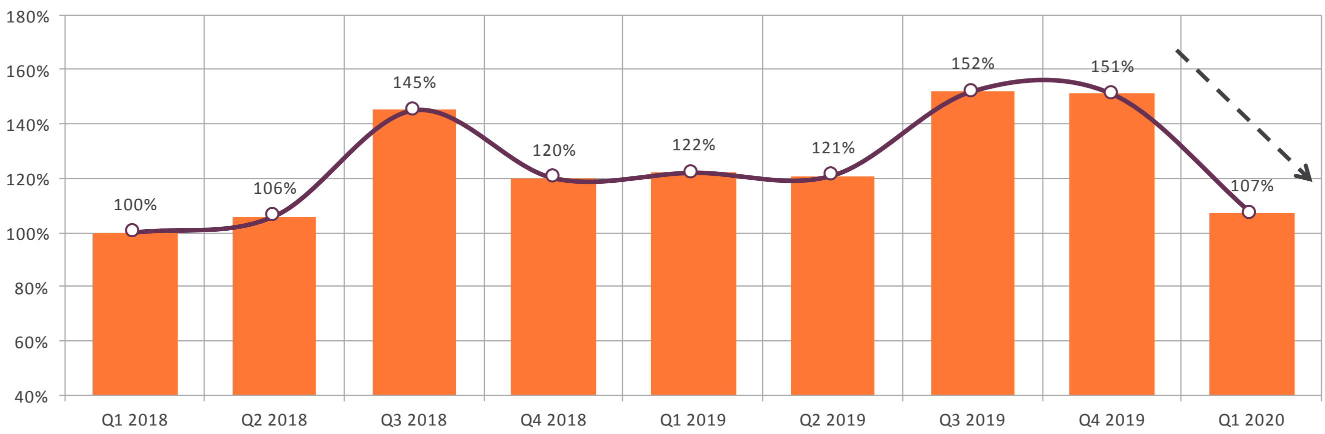
According to incoming requests, apartments with one to two bedrooms were in the biggest demand, comprising 41% and 32% of requests respectively.

The most popular apartments among clients (13%) are those in the Leningradsky Prospekt area (near the Anglo-American school), as well as those in the Arbat-Kropotkinskaya area, which accounts for 7% of all lots sold.

A significant number of requests are for rental apartments in the Lubyanka/Kitay-Gorod and Tverskaya/Kremlin districts (6.5% of demand respectively) and Patriarshie Prudy (6.4% of demand).

The current average budget for demand is 240,000 roubles per property per month. The first quarter of 2020 displayed a stable level for this indicator, with the exception of lower rates in March.

32 ▶ DYNAMICS OF CHANGES IN THE NUMBER OF REQUESTS FROM POTENTIAL TENANTS INTERESTED IN HIGH-BUDGET HOUSING IN MOSCOW, Q1 2018 – Q1 2020



Source: Intermark Relocation

SUPPLY

Since the beginning of 2020, we have seen a slight 7% increase in the number of offers in the Moscow high-budget rental market.

Approximately 2/3 of the supply of luxury apartments for rent (63%) is concentrated in five districts of Moscow: Arbat/Kropotkinskaya and Tverskaya/Kremlin (17% each), Leninsky Prospekt (10% of the market), Krasnopresnenskaya and Leningradsky Prospekt (9% each).

The average weighted budget of the proposal on the Moscow high-budget rental market at present is 312,000 roubles per object per month, which is 5% lower than at the beginning of the year. Over the past year, the proposed rental rate has decreased by 7%.

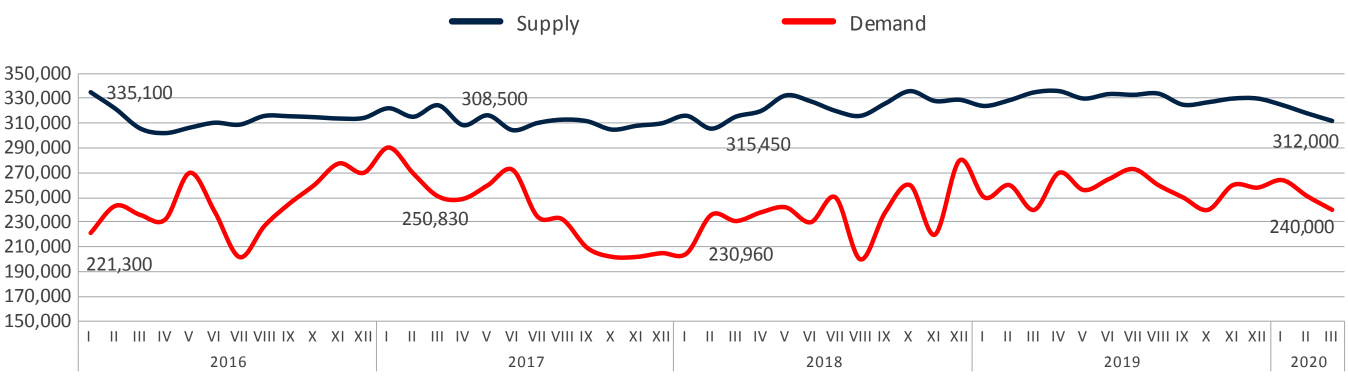
Similar dynamics are also demonstrated by the requested rates from tenants (240,000 roubles against 258,000 roubles at the beginning of the year).

Currently, most of the apartments for rent are exposed in roubles (75% of the market), while about a quarter are in foreign currency. Over the past month, the structure of distribution of offers from owners has not undergone significant changes – in March, the share of offers in dollars decreased by 1% compared to the previous month (25% in February).

In March 2020, the share of compact apartment options in supply increased. Currently, studios, one-bedroom apartments and one-bedroom options make up almost a third (31%) of all apartments available for rent, while a year ago (in March 2019) such options occupied a quarter (25%) of the market.

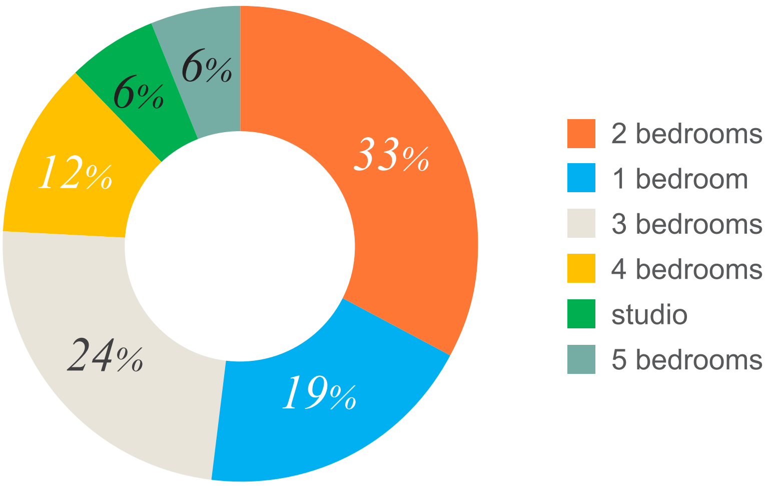
The value of the PCM TOP 100* index for the Moscow high-budget rental market in the first quarter of 2020 amounted to about 1.8 million roubles per object per month (USD 23,450 at the Central Bank rate as of 31 March 2020, 77.73 RUB/USD).

33 ▶ SUPPLY-DEMAND CORRELATION, RUB



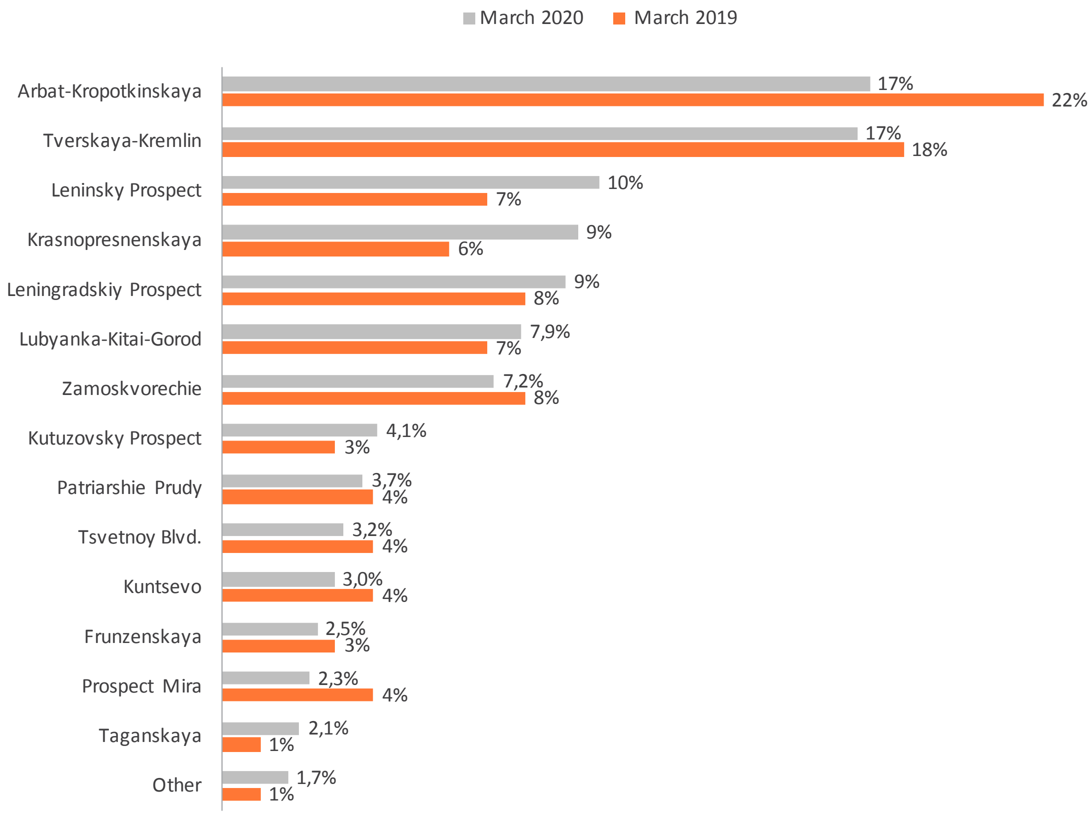
Source: Intermark Relocation

34 ▶ STRUCTURE OF SUPPLY IN TERMS OF NUMBER OF BEDROOMS



Source: Intermark Relocation

35 ▶ TERRITORIAL STRUCTURE OF SUPPLY (MARCH 2020/MARCH 2019)



Source: Intermark Relocation

36 ▶ TOP-10 AREAS IN TERMS OF SUPPLY

Place	Area	Rental rate in March 2020	Rental rate in March 2019	Rental rate in March 2018	Change for the year, %	Change for two years, %
1	Arbat/Kropotkinskaya	408,000	390,000	370,000	5%	10%
2	Tverskaya/Kremlin	340,000	347,000	320,000	-2%	6%
3	Krasnopresnenskaya	320,000	330,000	350,000	-3%	-9%
4	Tsvetnoy Boulevard	307,000	308,000	300,000	0%	2%
5	Lubyanka/Kitay-Gorod	300,000	270,000	290,000	11%	3%
6	Patriarshie Prudy	300,000	328,000	295,000	-9%	2%
7	Zamoskvorechie	280,000	310,000	320,000	-10%	-13%
8	Krylatskoe/Kuntsevo	260,000	260,000	285,000	0%	-9%
9	Leningradskiy Prospekt	250,000	307,000	314,000	-19%	-20%
10	Frunzenskaya	240,000	307,000	267,000	-22%	-10%
11	Kutuzovsky Prospekt	160,000	250,000	200,000	-36%	-20%
Average rental rate:		**312,000**	**335,000**	**315,500**	**-7%**	**-1%**

St. Petersburg market overview

Office market

In Q1 2020, the vacancy rate increased by 0.2 ppt and reached 6.4%. In March, the first signs of an upcoming recession became noticeable. The tenant's activity slowed down and almost stopped, while the number of requests to the landlords for rent free period, installment payments and lower rates increased.

The completions for Q1 2020 amounted to 25,000 sq m in 3 business centres. About 200,000 sq m of office premises are expected to be delivered to the market by the end of 2020.

Rental rates continued to grow. The stable demand in 2019 and the growing activity of Gazprom and IT companies led to increase of rental rates in January – February 2020. The average asking rents in Class A are at RUB 1,916/sq m/month, Class B rents are at RUB 1,312/sq m/month (including VAT and operating expenses).

Oil and gas and IT companies showed the highest demand on the St. Petersburg office market in recent years.

Retail market

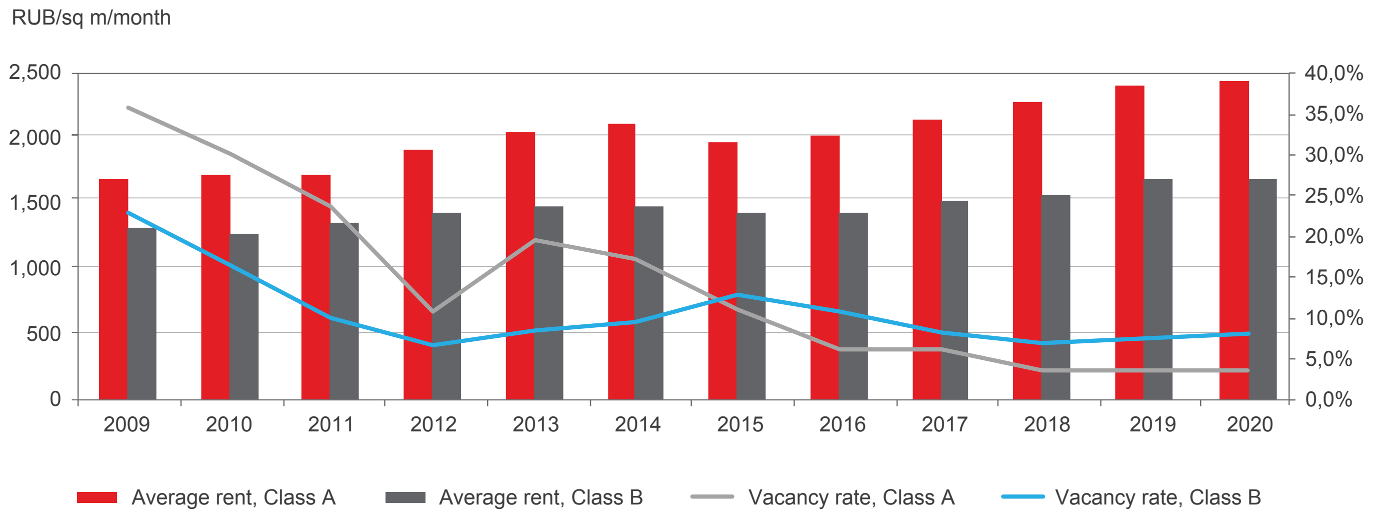
The shopping centres development in St. Petersburg is at a low level. In Q1 2020 no new quality shopping centres opened.

In Q1 2020, the vacancy rate reached 3.5%, it was 0.1 ppt lower than in Q4 2019. There was no mass outflow of tenants in March. Even with a significant traffic decline in shopping malls, retailers were primarily trying to modify the lease terms for a short period, rather than immediately leaving the premises. However, a further growth in the vacancy rate is inevitable.

In Q1 the rotation in shopping malls was minimal. By the end of March, some deals had been suspended and retailers had adopted a wait and see approach. Among those who managed to open or to announce the opening of shops were Calvin Klein Jeans in Europolis, The North Face in Gallery and Alexander Bogdanov boutique in Nevsky Center. Among new brands not previously represented in the city, Italian cosmetics stores Kiko Milano announced the opening in Okhta Mall and in Raduga.

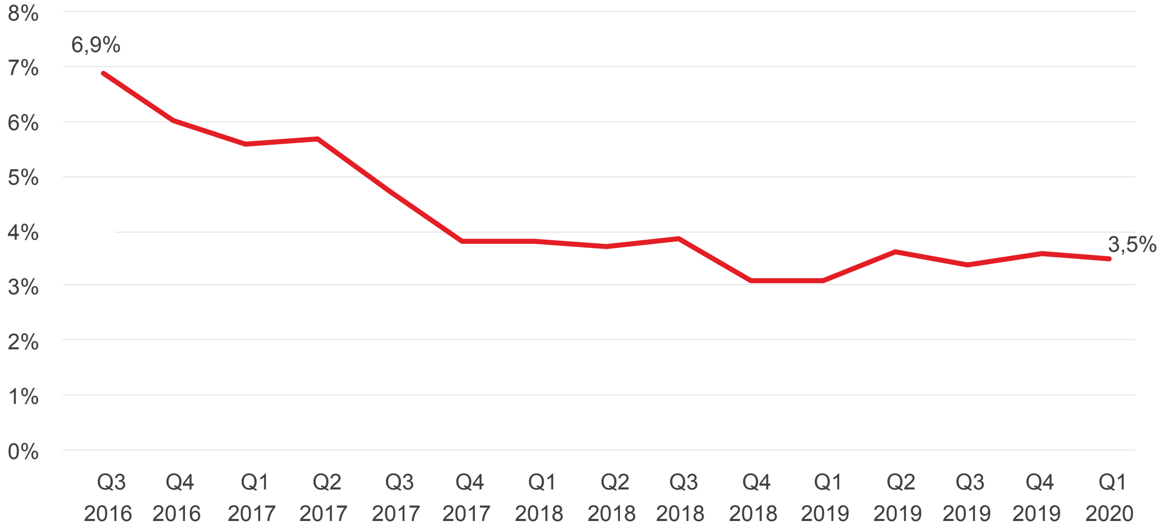
By the end of Q1 2020 prime base rents in quality shopping centres increased to RUB 80,000/sq m/year (excluding VAT and operating expenses).

37 ▶ RENTAL RATES AND VACANCY RATE IN THE ST. PETERSBURG OFFICE MARKET



Source: JLL

38 ▶ VACANCY RATE IN ST. PETERSBURG SHOPPING CENTRES



Source: JLL

Street retail market

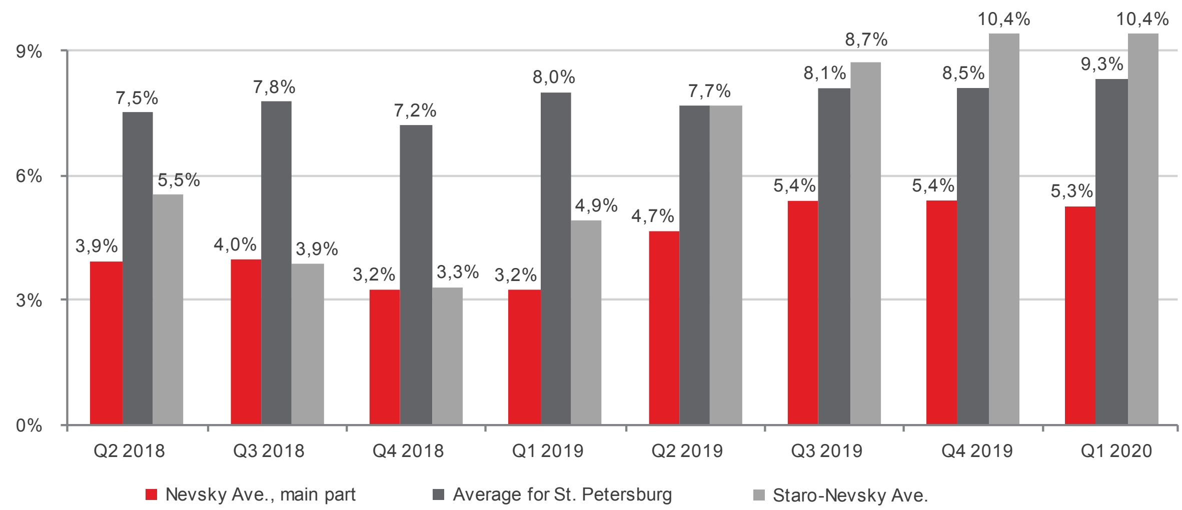
St. Petersburg street retail market was among the first sectors to encounter difficulties at the end of March 2020. The vacancy rate in Q1 increased by 0.8 ppt and amounted to 9.3%. This is the highest level observed in the last 5 years. We expect a further growth of the vacancy rate.

Limited consumer demand, real income declines in Q4 2019, as well as macroeconomic uncertainty in 2020 led to the active closure of fashion operators. Previously, the main rotation was observed in the food service sector, however now for the first time the segment of clothing, shoes and accessories has the highest number of closed stores in street retail.

The maximum vacancy rate was observed on the main fashion streets. 10.4% of stores are empty on Bolshoy Avenue of Petrograd Side, Bolshaya Konyushennaya Street and Staro-Nevsky Avenue.

New brands entered the market. Tissot announced the opening of a shop on Nevsky Avenue. French clothing brands

39 ▶ VACANCY RATE DYNAMICS ON NEVSKY AVE. COMPARED TO THE AVERAGE



Source: JLL

Maje and Sandro opened their first shops in St.Petersburg on Bolshoy Avenue of Petrograd Side. Russian brand Sodamoda opened at Bolshaya Konyushennaya Street. Availability of high-quality vacant space on the main fashion streets of the city, such as the one previously occupied by Dixy on Staro-Nevsky Avenue, provides an opportunity for operators that have long planned to enter the St. Petersburg market with a flagship project.

Warehouse market

No warehouse complex was completed in Q1 2020. About 300,000 sq m are scheduled for 2020.

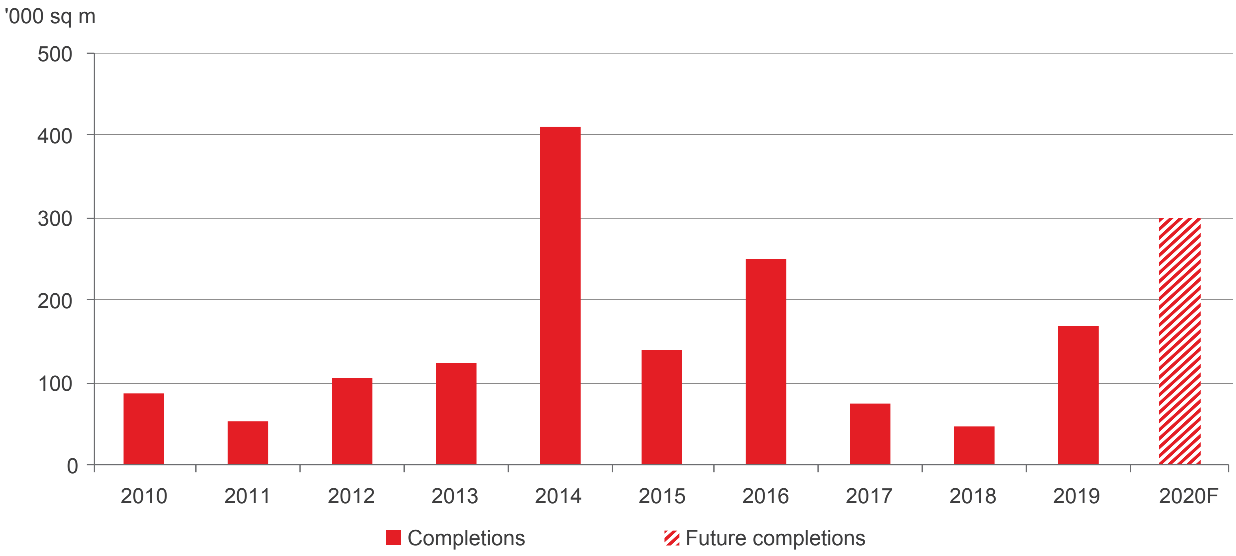
In existing warehouse complexes asking prime rental rates did not increase despite the positive dynamics of demand.

Stable demand for warehouse premises and a lack of new speculative supply in Q1 2020 led to a further decline in vacancy rates. As of the beginning of April, 104,000 sq m or 3.5% were vacant.

The e-commerce share in the deals' structure has been growing for the third year in a row. The growing demand for online sales during the period of self-isolation only strengthens the position of online trading. The companies rent new warehouses, optimizing logistics and reducing delivery times.

In Q1 2020, the largest deal on the market was made by OZON. 28,700 sq m were leased in the Marvel Logistics project, which is under construction.

40 ▶ COMPLETIONS IN THE ST. PETERSBURG WAREHOUSE MARKET



Source: JLL

Hot topic:

COVID-19: key amendments to the lease framework

Ilya Skripnikov
Partner, Head of EY Law Real Estate, Construction and PPP practice in Russia

Konstantin Litovkin
Senior Associate, EY Law Real Estate, Construction and PPP practice in Russia

Anna Strelnichenko
EY Partner, Head of Real Estate, Infrastructure, Transportation & Government Sector Tax Services in the CIS

Alexander Galutskiy
Senior Manager, EY Tax & Law

INTRODUCTION

COVID-19 pandemic remains one of the greatest challenges the Russian business has ever faced so far. The rental sector is not an exception.

Many Russian companies are now committed to cut down costs due to a significant drop of turnover. Some tenants are no longer able to pay the rent and therefore are forced to renegotiate the rent with their counterparts. As a result, many questions arise about the effect COVID-19 may produce on the lease contracts and the legal remedies tenants may consider and resort to.

In turn, the Russian authorities have recently implemented a number of measures to combat the spread of COVID-19 pandemic. Some of these measures are resulted in a broad range of amendments into Russian legislation.

Below we focus on those legal and tax amendments which we find vital for the lease framework as they may directly impact lease contracts executed so far.

FEDERAL MEASURES

On 1 April 2020 the President signed Federal Law No. 98-FZ "On Amendments to Certain Legislative Acts of the Russian Federation on the Prevention and Elimination of Emergency Situations" ("Law No. 98-FZ"). The provisions of Law No. 98-FZ which directly pertain to the lease framework are outlined in Article 19 thereof and, in principal, allow the tenant to claim for (i) deferral of rent and/or (ii) reduction of rent. Each of these new provisions could be summarized as follows.

Rent deferral

A landlord shall execute an addendum to the lease contract setting forth the deferral of rent in 2020 within 30 days after tenant's dedicated notice. This deferral extends only to lease contracts executed before the enactment of emergency or high-alert regime in the region where the leased immovable property is located. As of now, almost all regions effected by the spread of COVID-19 have already adopted these acts. For instance, in Moscow the high-alert regime was introduced on 5 March 2020.

Detailed deferral requirements are further disclosed in the Resolution of the Government of the Russian Federation No. 439 dated 3 April 2020 ("Resolution No. 439"). Pursuant to Resolution No. 439, the deferral is available only to legal entities and individual entrepreneurs operating in those sectors of the Russian economy which have suffered the most due to the spread of coronavirus infection. Resolution No. 439 fails to specify these sectors explicitly.

One may argue that the list of these sectors is provided in Resolution of the Government of the Russian Federation No. 434 dated 3 April 2020 ("Resolution No. 434") which, inter alia, sets forth debt relief under credit facilities for small and medium sized entrepreneurs who conduct activity, pursuant to OKVED codes enlisted in Resolution No. 434, in the following sectors:

- air and road transportation, airport activity;
- culture and entertainment activity;
- athletic and health-improving activity, sport;
- travel and other activities in the tourism sector;
- hospitality industry;
- public catering;
- activities of additional education organizations, non-governmental educational organizations;
- conference and exhibition organization activities;
- household services;
- healthcare;
- non-food retail activities.

Due to the amendments introduced into Resolution No. 434 the actual list of those legal entities and individual entrepreneurs who may benefit from the deferral is no longer limited to credit facilities for small and medium sized entrepreneurs. We recommend to monitor Resolution No. 434 from time to time for further updates as COVID-related legislation undergoes constant amendment process and the list of those legal entities and individual entrepreneurs who may benefit from the deferral may be further extended.

Whenever the deferral conditions are negotiated, the following rules provided in Resolution No. 439 should be considered:

- rent shall be deferred in the following amounts: (i) 100% of rent – from the introduction of high-alert or emergency regime until the relevant regime has been abolished; and (ii) 50% of rent – from the date the relevant regime has been abolished until October 1, 2020;
- the deferred rent shall be payable within the interim between January 1, 2021 and January 1, 2023, by equal installments, each of which shall not exceed 50% of the monthly rent and shall be made on monthly basis (at most);
- no liability measures shall apply for a failure to observe the deferred rent payment milestones;
- deferral does not extend to utility payments;
- lease contract may stipulate additional conditions to the extent they do not aggravate the deferral (as specified above).

Reduction of rent

The tenants, irrespective of business activities they normally carry out, may claim for the reduction of rent in 2020 should they become unable to use the leased immovable property due to the introduction of high-alert or emergency regime.

Law No. 98-FZ fails to disclose to which extent the rent may be reduced: partially for the entire calendar year or otherwise, e.g. to the full extent within term high-alert or emergency regime remains in force. Clearly, the reduction merits could be interpreted differently.

Unlike the deferral provisions, Law No. 98-FZ sets forth no counter obligation of the landlord to satisfy the tenant's claim or otherwise negotiate the rent deduction, hence we expect this issue to be further considered and interpreted by courts once regular proceedings are resumed (para. 3 art. 19 thereof).

REGIONAL MEASURES

Regional authorities also establish provisions to support proprietors who may face losses due to the outbreak of

COVID-19 pandemic and the enacted high-alert regimes. These measures may vary from region to region and we encourage to check regional legislation where the leased immovable property is located.

For instance, in Moscow the Government adopted Resolution No. 212-PP dated 24 March 2020 ("Resolution No. 212-PP"). Resolution No. 212-PP, as amended, grants the state aid in the amount of property tax and land tax (or land rent) for the owners of buildings/premises used for accommodation of:

- retail catering and consumer facilities, including shopping malls – within the period activity has been suspended (at least, until 1 July 2020);
- hotels – for quarter II of 2020.

The state aid shall be made pro rata to the area leased out to tenants: in respect of rented space – 100% of payments shall be refunded, in respect of space used by the owner – 50% of payments shall be refunded. It is currently unclear how exactly such state aid would be calculated in different cases and in which form it would be provided to the real estate owners. This should be clarified in the special rules to be issued by the Moscow government.

In addition to the state aid, owners of the above property are granted with a deferral of lease payments for the second quarter of 2020 for the publicly owned land plots they occupy until 31 December 2020 (inclusive). The same deadline has been assigned for advance property and land tax payments.

The above measures are subject to the following conditions:

- buildings/premises are closed due to the enactment of high-alert regime (applicable only to retail, catering and consumer facilities);
- owner decreases rent payments for space leased out to tenants in the amount not less than twice the amount of property tax, land tax, rent for the land plot for the period and this reduction is at least 50% of the original rental rate.

Furthermore, those tenants (legal entities and individual entrepreneurs) who (i) carry out activities enlisted in Resolution No. 212-PP, including retail, catering, consumer, hospitality services, and (ii) lease out land plots or non-residential space owned by the City of Moscow are additionally released from the obligation to pay rent under the dedicated lease contracts from 1 March 2020 and until the high-alert regime in Moscow is abolished (at least, until 1 July 2020). This relief applies whenever the purpose for granting these assets into lease corresponds to one of the activities named in Resolution No. 212-PP and duly documented.

CONCLUSION

The above amendments are aimed to reduce rent burden for the business, however, they do not cover all companies that may lease commercial property. Measures adopted so far, at least on the federal level, are primarily focused to protect tenants and ignore landlords who may have obligations towards creditors, e.g. banks, and therefore depend on the rental income.

These measures may be further extended and become even more tenant-friendly if/when a new draft law is enacted which is supposed to entitle tenants with the right to unilaterally refuse from the lease contracts executed prior to the enactment of high-alert regime at no additional charge and without compensation of losses (lost profit and losses arising from termination of the lease contract) in case the tenant's monthly income drops by more than 50% since the enactment of high-alert regime. As of now, the draft law undergoes second reading in the State Duma and has already managed to provoke a wave of criticism from many landlords. If passed in the current wording, the draft law may produce a negative impact on the rental sector.

Unless the authorities extend the protective measures aimed to support landlords and include additional businesses which may benefit from the rent deferral, there is a high chance that the number of court disputes over the rent payments will only increase.

Hot topic:

Key issues of a reliable contractor awarding procedure

Nikolay Irov
Project manager,
Drees & Sommer

Success or failure of a construction project implementation, however as much as any other of the kind, depends on numerous decisions made by a customer or on his behalf. These decisions are taken at all project stages, starting from feasibility study, concept development, design and construction up to project commissioning and operation. One of these actions is to select a contractor, within qualification of potential bidders and evaluation of their proposals. Properly organized selection process results in positive long-term relationships between participants, minimization of risks and project cost optimization.

To complete this task, the customer should have reliable procedures and evaluation criteria. In response to the increasing demands from customers over the past few decades, construction industry has introduced many technological changes in design and construction processes, and, in project management as well. Nevertheless, tendering for a contractor, including evaluation of proposals remained, basically, unchanged. The widespread use of electronic bidding forms made the procedure for receiving and evaluating of offers more efficient, though did not make fundamental changes to the organization of this process, as did, for example, BIM in design or lean management in construction.

Thus, awarding a contractor covers qualification and evaluation of bidders' offers. During qualification process the customer collects information about a contractor and evaluates its ability to complete the task. As a result, the customer has in his hands a list of organizations that may subsequently be invited to participate in tenders and submit their proposals on a regular basis.

To be included in such a list, each contractor is evaluated as per its financial stability, organization structure, quality of organizational management, technical expertise, quality of material base and availability of qualified specialists, previous experience of similar projects implementation, level of workload at the time of an expected start of works and references provided by the other parties: previous customers and subcontractors of the bidder.

Depending on a project scale, the number of potential contractors, which are available on the market, and capable of carrying out the works required, and so are subjected to evaluation, can be quite large. Often this list is groundlessly reduced, because evaluation criteria chosen inappropriately distort the essence of the tasks set for the contractor and the general objectives of the project or because of the narrow market reach – lack of information about existing contractors. Though, selected companies are subject to detailed assessment.

Assessment of financial stability includes analysis of financial statements of the company and obligations under existing contracts.

Technical evaluation confirms available labor resources and required equipment, company's capability to organize operation on a construction site and perform necessary types of work in sufficient volume and with quality specified. This requires a visit to existing construction sites where a potential contractor is involved, discussing an approach to project organization, schedule, client's requirements with the management of a potential bidder.

While qualifying the contractor that specializes in a certain type of works, it is quite natural to check available resource base of equipment and tools, personnel qualifications as well. This task is somewhat more difficult when bidding for the general contractor since the most common approach is when the general contractor has only a minimum set of own equipment and a staff of technical personnel, involving work-specialized subcontractors and man power for a specific project. Here, more attention should be paid to evaluating the management team and key technical specialists of the general contractor, with special attention to feedback from the previous customers.

Analysis of the previous experience of a prospective contractor should be carried out with some accuracy. A large portfolio of orders, including field-specific ones, in the past, and moreover those in present, does not guarantee success of a particular project: the company may be "overloaded", the team that has successfully implemented reference projects may be engaged in other projects or even leave the company. On the other hand, almost every reputed contractor started its operation as a small company, gradually developing and taking on new projects, both in technology and in volume.

The quality of organizational management is evaluated as per company's strategy for conclusion of contracts, approaches to managing claims and customer's change requests, accepted risk management procedure.

Experience shows that the current level of contractor's workload at the time when the project is supposed to start frequently turns to be the main reason why the contractor is not able to fulfill its obligations under the contract. Quiet often, the customer is faced with a situation where, somewhere in the middle of the project, it becomes obvious that the customer's funds are used to finance works on other contractor's projects and customer's project is being implemented by a leftover principle. In this regard, up-to-date information about the bidder's current workload is very important. One should carefully check if the potential contractor is able to execute the required amount of work within timelines scheduled.

Organizations that tender for construction contractors on a regular basis, such as, for example, large manufacturing companies with an extensive branch network or companies providing professional construction management services, have developed regulations and sets of criteria for conducting a qualification assessment, which often includes a checklist with a developed scoring system. To minimize subjectivity, at least three people on the part of the customer, with a sufficient level of competence, are involved in the assessment. Usually such a list of contractors is always ready at hand for any project. Though, it must be noted that the list is regularly reassessed and updated.

Proposals received from pre-qualified bidders are evaluated as per technical and financial parameters. Herewith, many parameters that were considered during qualification stage, such as financial stability or technical expertise, are subject to more detailed analysis. A set of evaluation criteria is determined for each project. The main criteria for evaluating proposals: cost, terms of implementation and quality of previously executed comparable works. Additional secondary criteria can be introduced, the set of which and weight of each in the final assessment reflects the specific requirements of the customer. These can be, for example, fulfillment of special requirements to the procedure for works financing or guarantee liability.

After choosing a contractor and before signing the contract, it is recommended to make a final check to confirm earlier evaluation results, technical and cost parameters of the project.

AEB REAL ESTATE COMMITTEE

The AEB Real Estate Committee was founded in 2003 and brings together real estate professionals from a variety of areas including developers, investors, financiers, consultants, project and facilities managers, and other service providers.

The Real Estate Committee has three primary objectives around which its activities are structured: to facilitate the exchange of information regarding real estate and development issues in Russia; to influence existing procedures in order to increase the attractiveness of foreign and domestic investment; and to establish a 'bridge' between the AEB, the Moscow Government, the State Duma and other relevant governmental bodies.

AEB REAL ESTATE COMMITTEE MEMBERS:

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For more information please contact:

Saida Makhmudova, Committee Coordinator, at saida.makhmudova@aebrus.ru