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Contents

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The "AEB Real Estate Monitor" is registered with The Federal Service for Supervision of Legislation in Mass Communications and Protection of Cultural Heritage, Certificate registration ПИ № ФС77-24458/ СМИ "АССОЦИАЦИЯ ЕВРОПЕЙСКОГО БИЗНЕСА: Обозрение рынка недвижимости" зарегистрировано в Федеральной службе по надзору за соблюдением законодательства в сфере массовых коммуникаций и охране культурного наследия.

Свидетельство о регистрации ПИ № ФС77-24458 от 23 мая 2006

Frank Schauff
Chief Executive Officer,
Association of European Businesses

Dear readers,

It is my genuine pleasure to welcome you to the third edition of the AEB Real Estate Monitor in 2017!

I hope you had a wonderful summer time and are going to start a new business season with fresh and bright impressions.

This issue will traditionally provide the overview of the Moscow and St. Petersburg real estate markets. In particular, the edition comprises data on retail, office and warehouse markets in terms of overall investment activity, completion level, and vacancy rate dynamics in the second quarter of 2017.

As always, a separate section reviews Moscow hospitality sector from the perspective of average daily rates and occupancy indicators. Figures on the number of the hotels opened in the first half of 2017 and announced for opening by the end of the year are also specified.

Supply and demand trends of the Moscow prime rental market are analysed based on various criteria including rental budget rates and the most popular areas.

The hot topics, as usually, deal with the most acute and in many cases widely discussed issues referring to the real estate. There is a general article about the current trends on the housing market; a specific article on cloud services for ventilation and air conditioning system manufacturers; and two more juridical-related topics concerning the 'unjustified tax benefit' concept, and the courts' approach to lease termination.

I would like to express my sincere gratitude to the members of the AEB Real Estate Committee for their substantial contribution to the present publication and other activities.

A new business season has just started and I hope to meet you at the upcoming AEB Real Estate Committee events.

Enjoy your reading!

Filippo Baldisserotto
Chairman of the AEB Real Estate Committee,
General Director,
Stupino 1 Industrial Park

Dear readers,

We are back to business after summer holidays and looking with a fresh mind on the development in the real estate sector.

So far the new normal seems to get hold of the market and it continues to evolve with the same dynamics that we have seen before.

Even if the residential construction has dropped 10,4% in the period of January-July 2017, the overall figure of construction works for the same period is slightly over 100%.

The preparation for the AEB Real Estate Day scheduled for 27 September 2017 is in full swing and we invite all interested parties to contribute to this event to make it informative.

Thank you all and looking forward to seeing you at the upcoming Real Estate Committee meetings and other events.

Moscow market overview

Capital market, Q2 2017

• Supported by a stable currency and the recovery of the Russian economy, investor activity on the real estate market improves, with the number of investment deals increasing.

• In H1 2017, investment volume on real estate market increased by 39% YoY to USD 2.2 billion.

• In H1 2017, retail was the most active sector, accounting for 41% of the total volume. The office sector followed, with 32% of all transactions. In Q2, the largest deal was the sale of Vozdvizhenka Centre to Fosun Group and Avica Management Company.

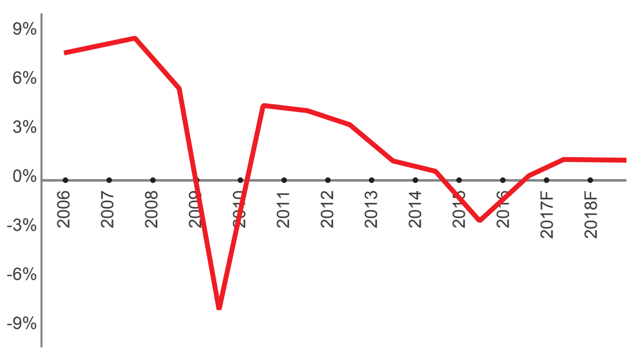
• Moscow remained the most attractive for investors in Russia in H1 2017, with a 73% share of the total volume. The share of St. Petersburg grew to 18%.

• In H1 2017, foreign investors increased their share to 21%.

• Benchmark prime yields remained unchanged between 9.0-10.5% for Moscow offices and shopping centres and 11.0-12.5% for warehouses.

• We expect the positive investment momentum to extend into the near future. We forecast the investment volume to reach USD 4.5 billion in 2017. (**1–9** ▶)

1 ▶ RUSSIA REAL GDP GROWTH

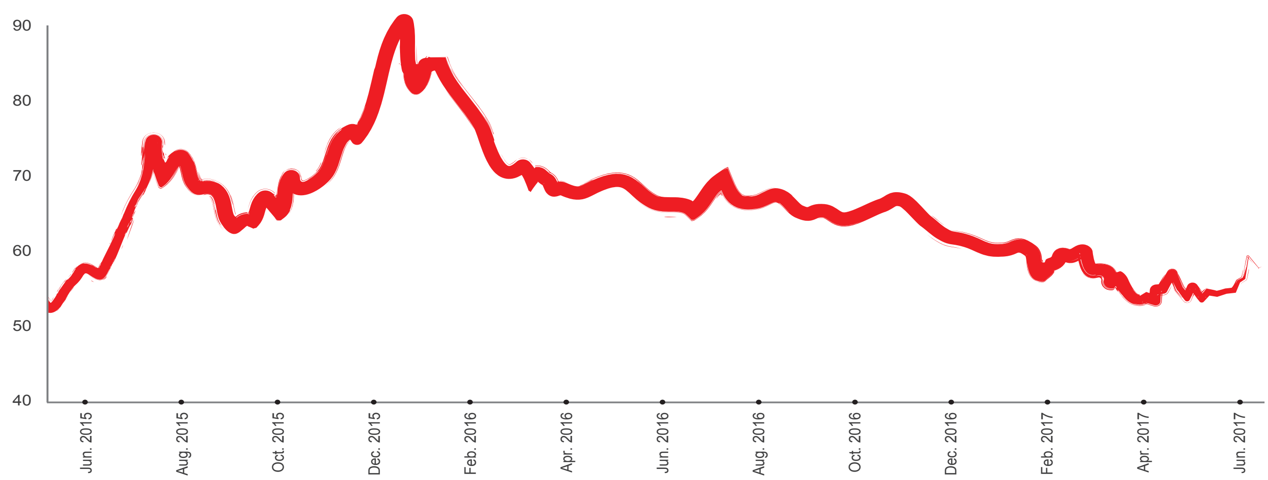


Source: Rosstat, Oxford Economics

2 ▶ SOVEREIGN BOND YIELDS

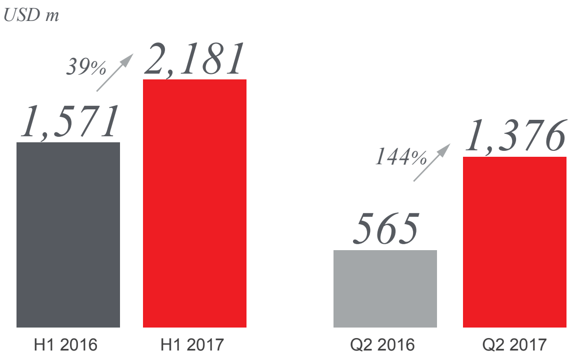
Source: Bloomberg, U.S. Treasury

3 ▶ EXCHANGE RATE DYNAMICS, USD/RUB



Source: Central Bank of Russia

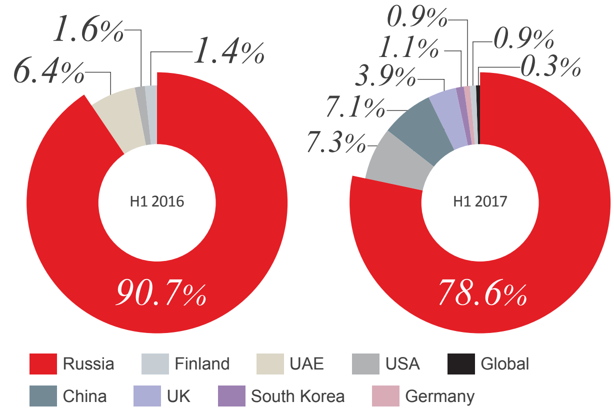
4 ▶ RUSSIA INVESTMENT VOLUME DYNAMICS*



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

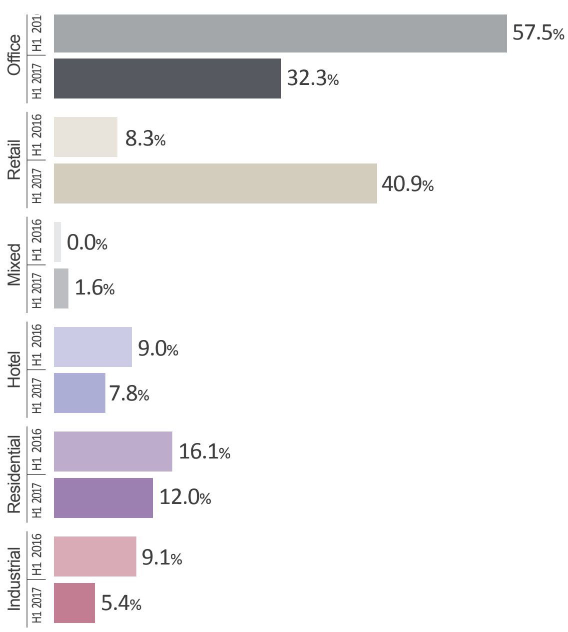
Source: JLL

5 ▶ INVESTORS BY SOURCE OF CAPITAL



Source: JLL

6 ▶ INVESTMENT VOLUME BREAKDOWN BY SECTOR



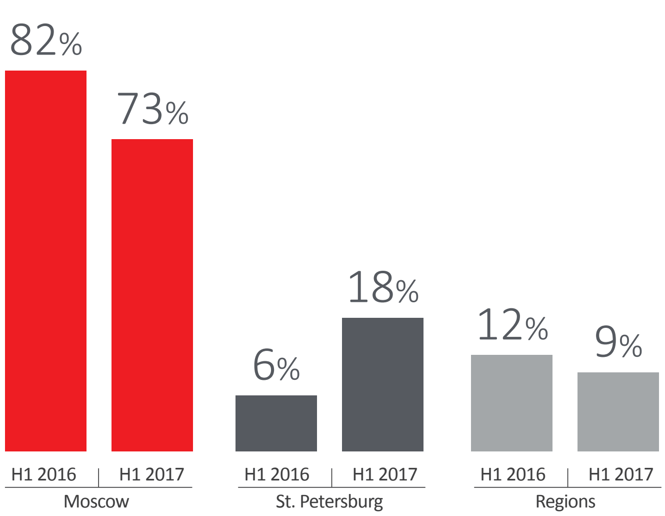
Source: JLL

7 ▶ PRIME YIELDS IN MOSCOW, Q2 2017

min		max
9.0%	Office	10.5%
9.0%	Shopping centre	10.5%
11.0%	Warehouse	12.5%

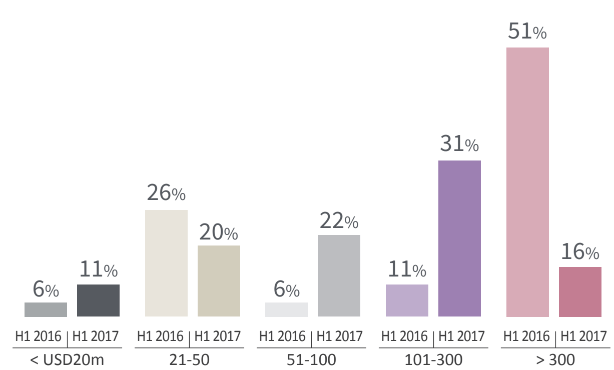
Source: JLL

8 ▶ INVESTMENT VOLUME BREAKDOWN BY REGION



Source: JLL

9 ▶ INVESTMENTS BY DEAL SIZE (BY VOLUME)

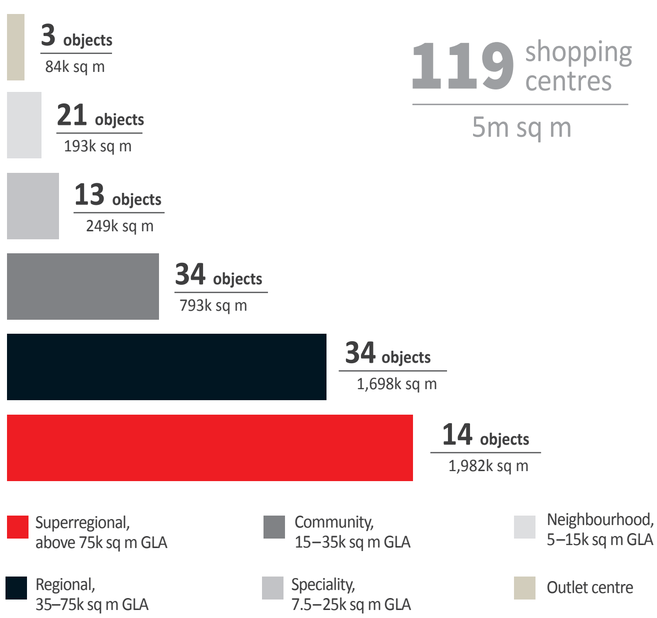


Source: JLL

Retail market, Q2 2017

• There were no completions on the Moscow retail market in H1 2017. The 236,700 sq m* of new supply announced for delivery in H2 2017 will put the annual volume at half of last year's level and will mark a four-year low. The main projects expected this year are Vegas Kuntsevo (113,400 sq m), Vidnoe Park (45,000 sq m) and Arena Plaza (20,000 sq m).
• The vacancy rate in existing shopping centres declined from 7.2% to 6.4% in Q2 2017. The lack of completions and significant new retail volume delivered to the market over the past three years (about 1.6 million sq m) encouraged retailers to expand their presence in Moscow shopping centres opened in 2014-2016.
• 24 new international retailers appeared on the Russian market in H1 2017. The activity is comparable to H1 2016, when 26 new brands entered the Russian market.
• Newcomers generally prefer to start their operations in shopping centres: 71% (17 of 24) did so in H1 2017. Premium and luxury retailers prefer to open their first stores in street retail (six of seven retailers opened stores in the main Moscow retail corridors). European retailers were the most active in the past six months, accounting for about 80% of new openings.
• Rents in shopping centres remained stable during the first half of the year, at RUB 195,000 per sq m per year for a single retail gallery unit of 100 sq m, and the average rent in retail gallery at RUB 74,000 per sq m per year. (**10–18**)

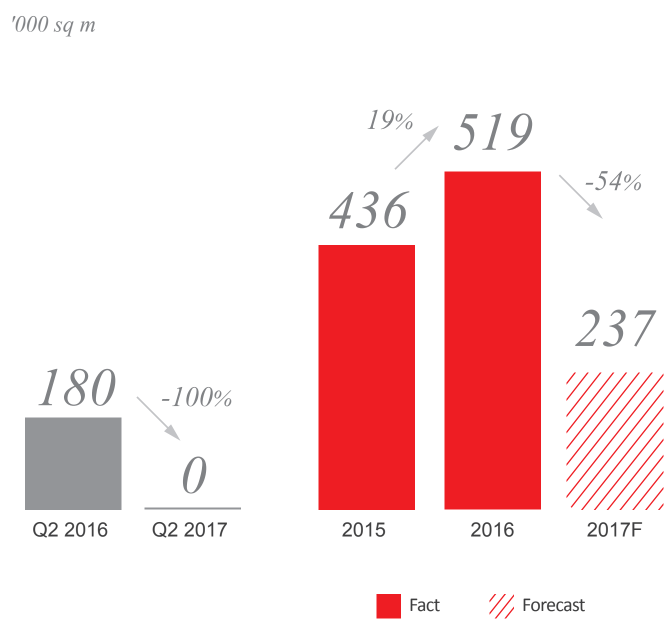
10 ▶ SHOPPING CENTRE SUPPLY**



**Moscow quality shopping centre stock figures were revised in Q2 in accordance with shopping centre classification.

Source: JLL

11 ▶ SHOPPING CENTRE COMPLETIONS

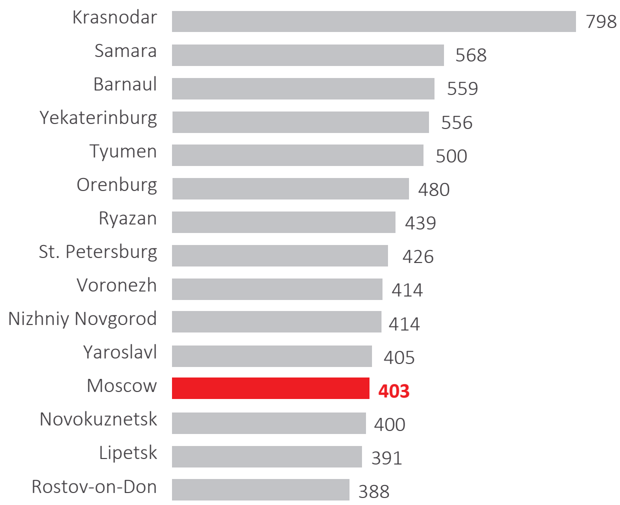


Source: JLL

* Hereinafter we use gross leasing areas (GLA)

12 ▶ SHOPPING CENTRE DENSITY IN RUSSIAN CITIES

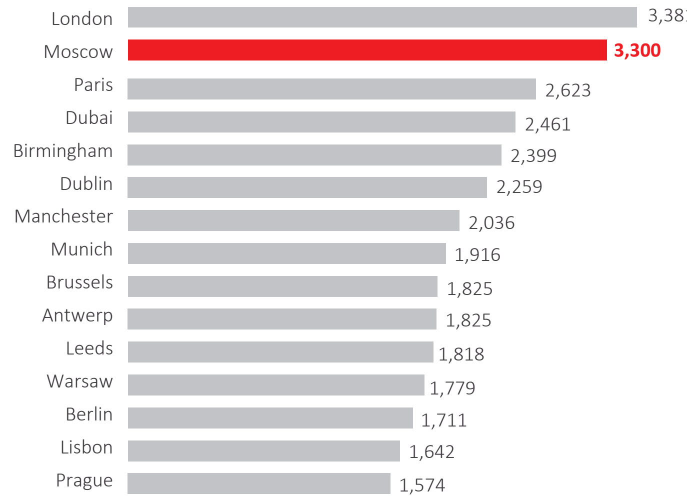
sq m/per 1,000 inhabitants



Source: JLL

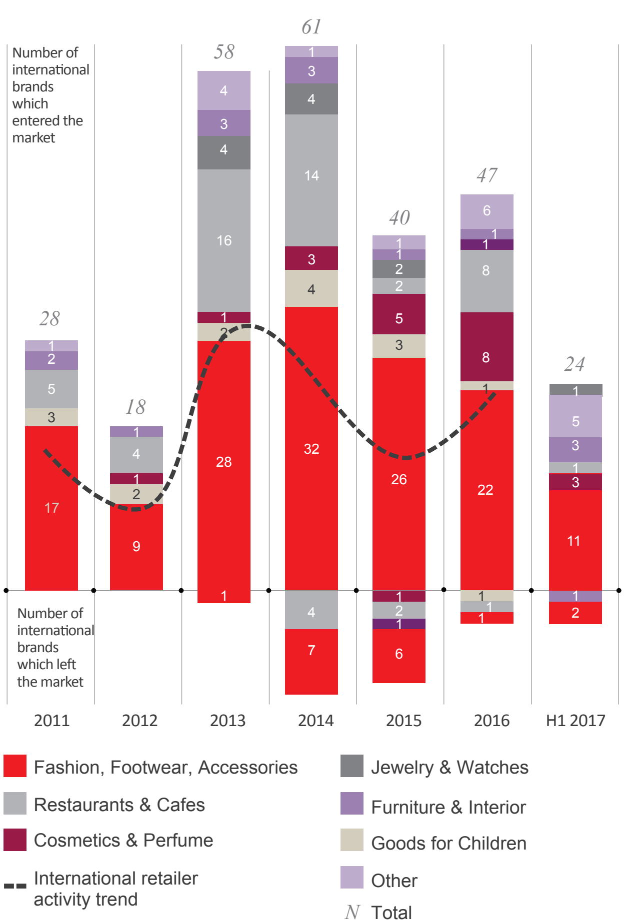
13 ▶ PRIME RENT: EUROPEAN COMPARISON

USD/sq m/year



Source: JLL

14 ▶ NEW RETAILERS ON THE RUSSIAN MARKET: ENTRIES AND EXITS



Source: JLL

15 ▶ AVAILABILITY

Overall SC vacancy rate

7.2% Q1 2017 — 80 bps — **6.4%** Q2 2017

*Prime SC vacancy rate**

0.6% Q1 2017 — 0 bps — **0.6%** Q2 2017

*Based on a selection of the most successful shopping centres with high footfall and conversion rates.

Source: JLL

16 ▶ PRICING**

Prime rent, RUB/sq m/year

195,000 Q1 2017 — 0% — **195,000** Q2 2017

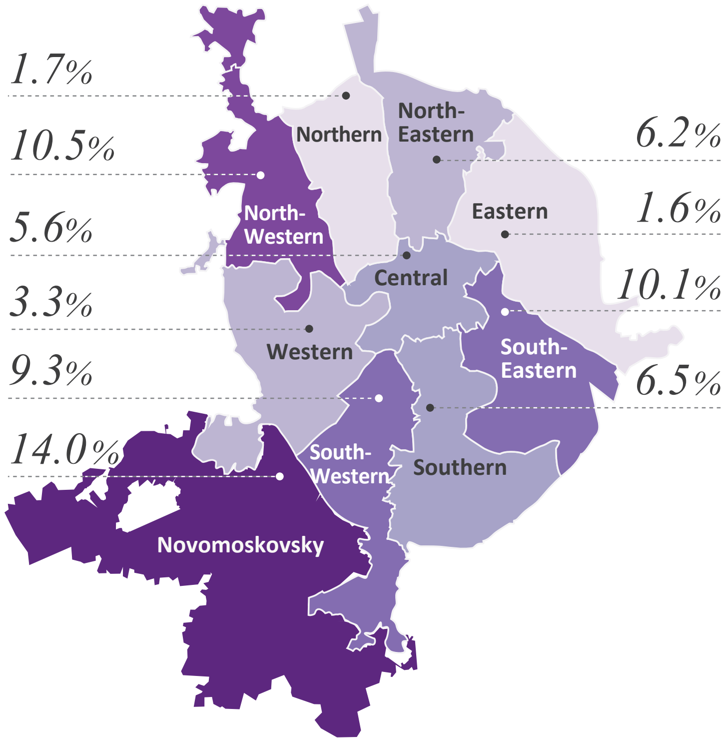
Average rent, RUB/sq m/year

74,000 Q1 2017 — 0% — **74,000** Q2 2017

**Rents are given for a single unit of 100 sq m GLA located on a ground floor of a retail gallery. Rents exclude VAT and OPEX. Higher level rents that exceed the market level are registered occasionally.

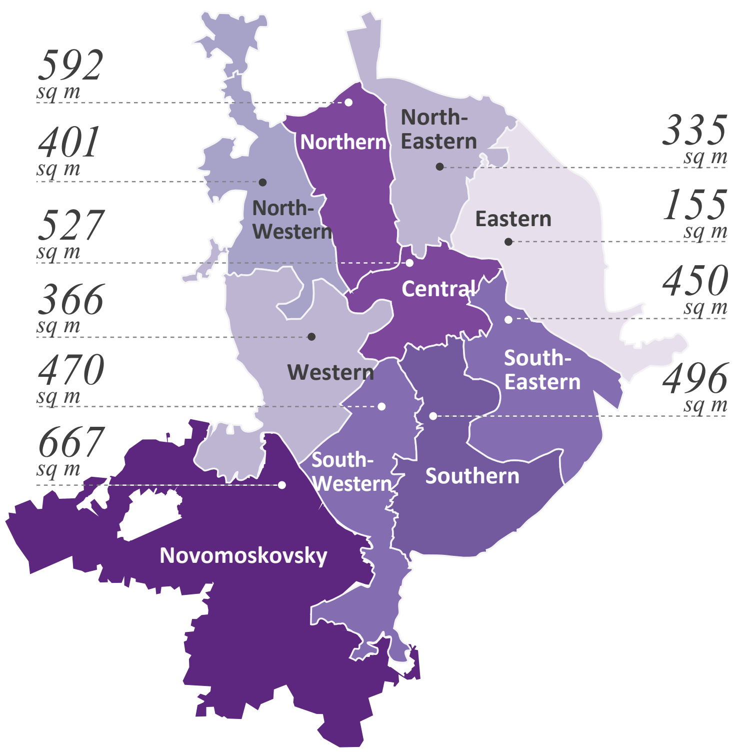
Source: JLL

17 ▶ VACANCY RATE IN MOSCOW DISTRICTS



Source: JLL

18 ▶ SHOPPING CENTRE DENSITY IN MOSCOW DISTRICTS (SQ M PER 1,000 INHABITANTS)

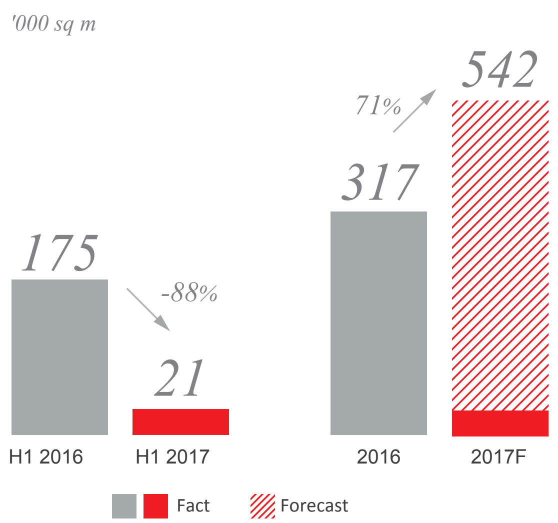


Source: JLL

Office market, Q2 2017

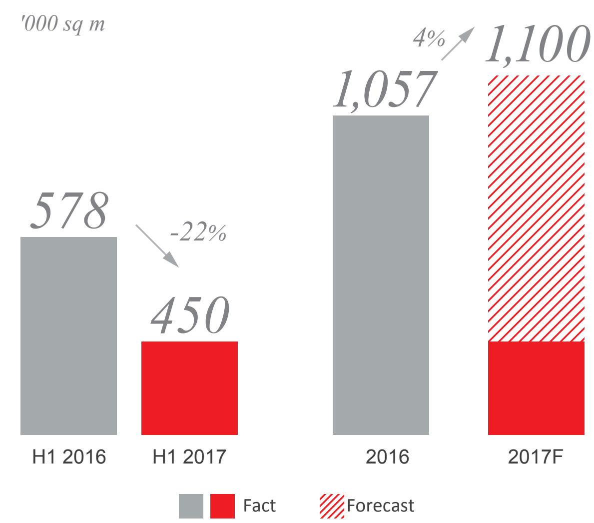
• In Q2 2017, no business centres were completed. The overall H1 2017 volume was 21,100 sq m, 88% lower than in H1 2016.
• About 542,000 sq m are expected for delivery in 2017. Most of these projects are located in Moscow City, IQ-quarter, Federation East, OKO Phase II.
• Take-up in Q2 2017 was 283,500 sq m, 41% higher than in Q1. The overall H1 2017 take-up was 22% lower YoY. As the demand composition normalises, the share of renegotiations and renewals in H1 declined to 19% (49% in 2016).
• About 80% of the deals in H1 2017 were closed by Russian companies.
• Some 35.3% of the overall take-up was recorded in decentralised locations outside the Third Transport Ring.
• The vacancy rate stayed roughly unchanged at 15%. In Class A, the vacancy rate declined by 0.7 ppt, to 16.7%, in Class B+ to 15.6%.
• Rental rates have remained stable in Q2. Prime rents at USD 600-750 (RUB 35,000-44,000), Class A rents at USD 400-670 (RUB 24,000-40,000), Class B+ at RUB 12,000-25,000. (**19–27 ▶**)

19 ▶ NEW SUPPLY



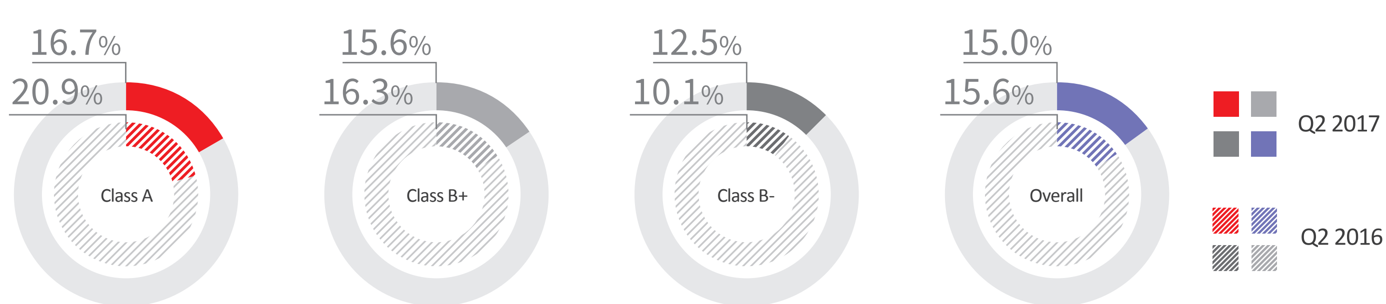
Source: JLL

20 ▶ OFFICE TAKE-UP



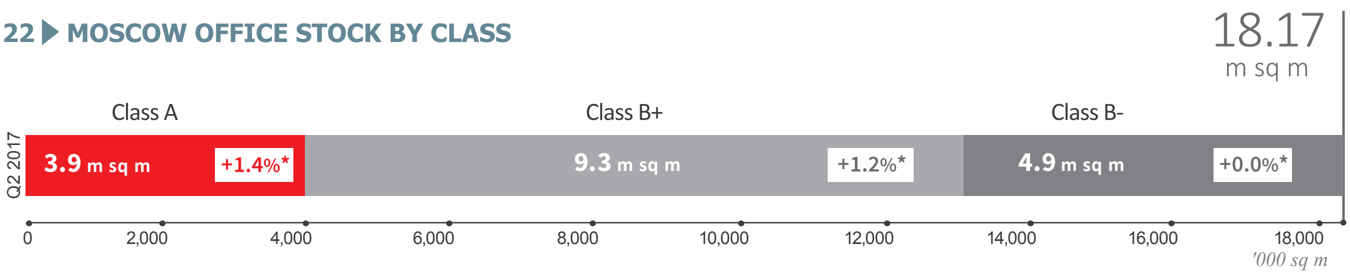
Source: JLL

21 ▶ VACANCY RATES BY CLASS



Source: JLL

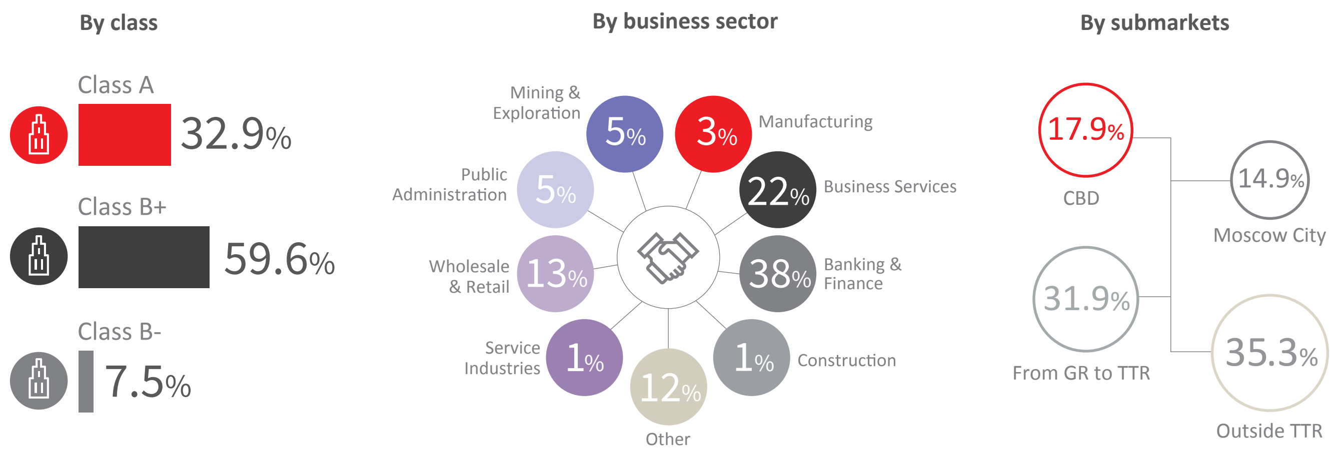
22 ▶ MOSCOW OFFICE STOCK BY CLASS



*Growth year over year

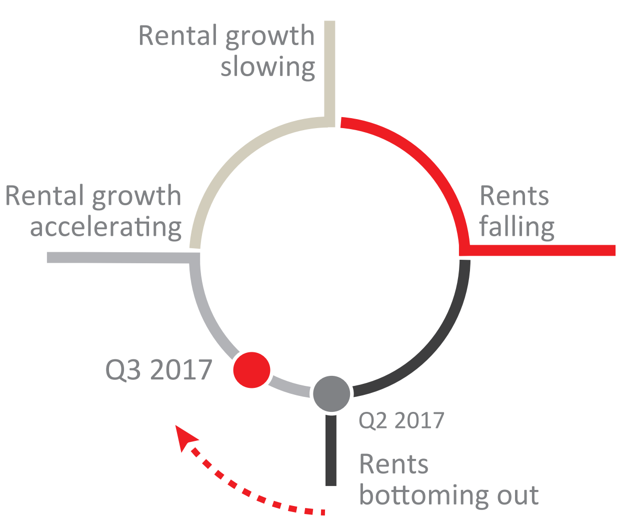
Source: JLL

23 ▶ TRANSACTED SPACE BY CLASS, LOCATION AND SECTOR, H1 2017



Source: JLL

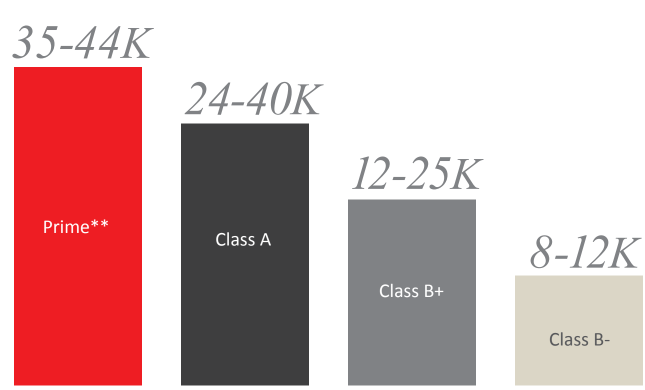
24 ▶ OFFICE PROPERTY CYCLE IN MOSCOW



Source: JLL

25 ▶ ASKING RENTS*

RUB / sq m / year



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

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

Source: JLL

26 ▶ MOSCOW OFFICE SUBMARKETS, Q2 2017

	CBD*	Moscow City	From GR to TTR**	Outside TTR***
Stock, sq m	3,985,747	934,080	4,481,440	8,767,410
Availability, sq m	529,093	154,744	554,918	1,487,413
Vacancy rate, %	13.3	16.6	12.4	17.0
Take-up, sq m	46,189	7,801	108,522	120,965

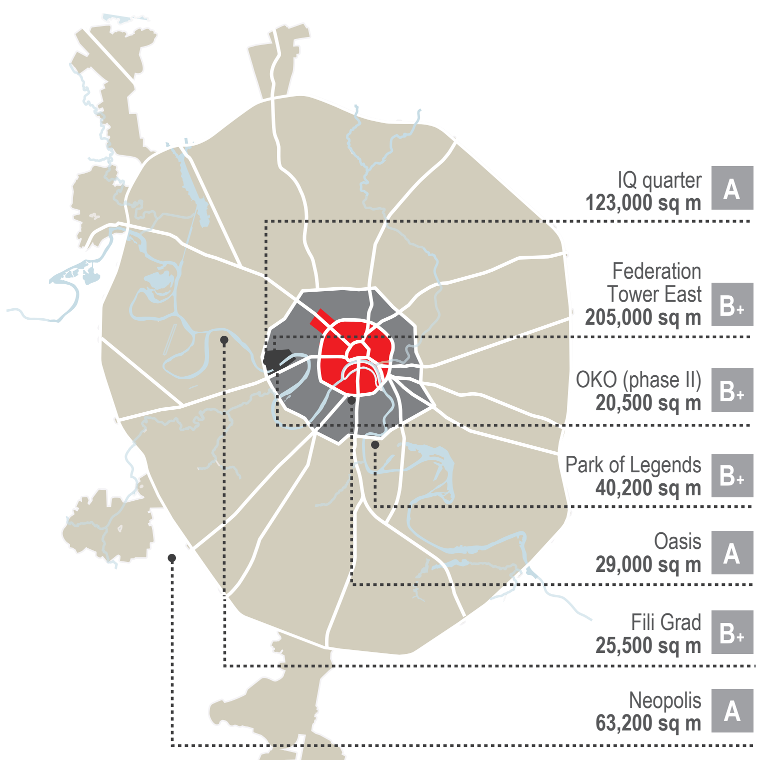
*The Central Business District submarket comprises the area within and in close proximity to the Garden Ring and Tverskaya-Yamskaya Street.

** Excludes Moscow City.

*** Including outside MKAD projects.

Source: JLL

27 ▶ KEY NEW SUPPLY IN 2017



Source: JLL

Warehouse market

TRENDS

The low transactions' volume in Q1 2017 did not represent the real market situation. In Q2, the market compensated for the decrease of Q1. In H1 2017, the take-up was 25% higher than the same indicator in 2016, which means that the demand in the Moscow region is stabilising. However, the record-high figures of 2015-2016 will not be reached in 2017. We expect the transactions' volume in class A and B to be around 1 million sq m, which is 10% lower than the average indicator in 2012-2016.

Considering that the supply is growing slower than the demand, the vacancy rate is expected to decrease by the end of the year and we will see the prerequisites for rental rate growth.

Despite the strong demand and low new construction volume, the rental rate in the Moscow region has decreased again in Q2 2017. The rental rate decline is most likely caused by several developers who are willing to take advantage of the low cost of construction and to dictate their terms to the market.

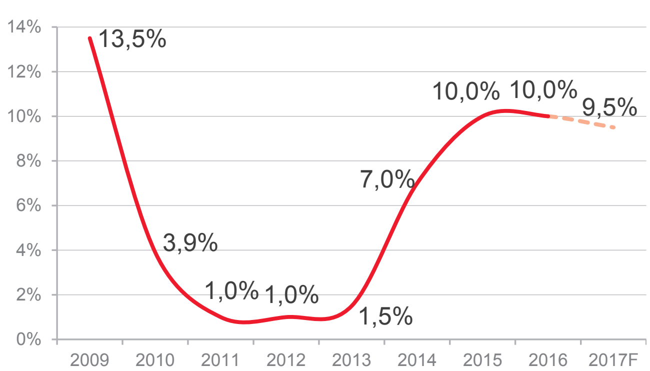
In the regions, the demand for warehouse space is noticeably stronger than in Moscow. In the first half of the year the take-up was higher than the annual indicator in 2016. There is a possibility that a record high transactions' volume will be reached. Since the existing supply is not able to meet such a high demand both by volume and by geographical coverage, the rental rate in some regions is increasing and vacancy rate is falling.

TRENDS. MOSCOW REGION

We expect the vacancy rate to decrease by 0.5 p.p. by the end of the year and to be 9-9.5%. This decline will happen because the transaction volume is expected to be around 1 million sq m which is much higher than the expected construction volume in 2017 (595,000 sq m).

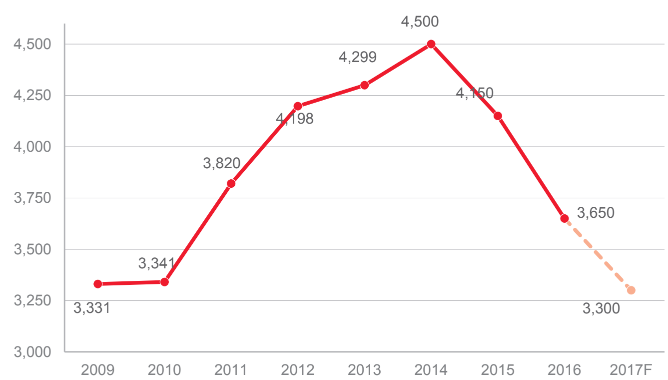
In Q2, the rental rate decreased by 10% and was RUB 3,300 per sq m per year, excluding VAT, OPEX and utilities. It is the lowest figure reached since 2009 on the Moscow market. (28, 29 ▶)

28 ▶ VACANCY RATE, CLASS A



Source: Cushman & Wakefield

29 ▶ NET RENTAL RATE*, CLASS A, (RUB/SQ M/YEAR)



* Rental rate excluding OPEX, utilities, VAT

Source: Cushman & Wakefield

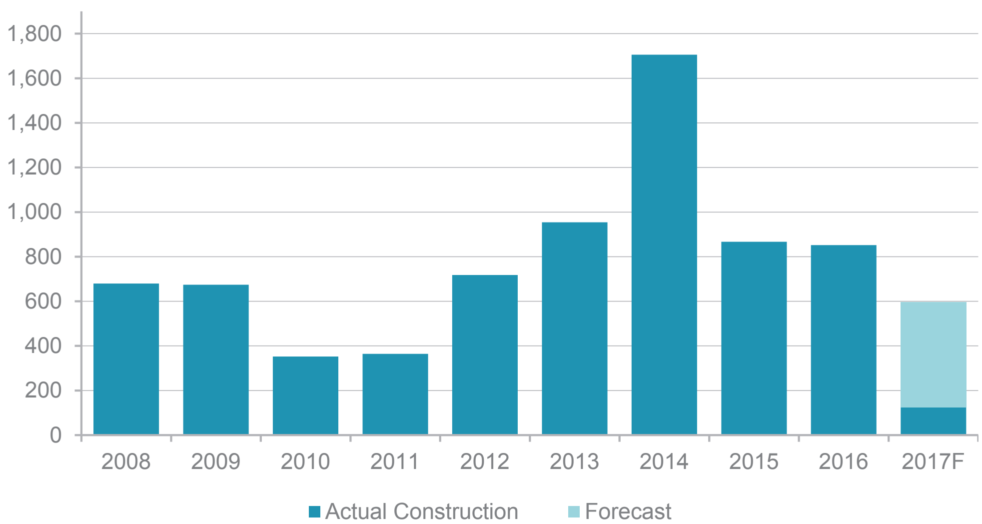
NEW CONSTRUCTION AND DEMAND. MOSCOW REGION

Construction volume in 2017 is lower than in 2016. In H1, 124,000 sq m of warehouse space was added to the market, which is almost 4 times less than in 2016.

We expect the new construction to reach 540,000 sq m in 2017, which is 30% lower than in 2015 and 2016.

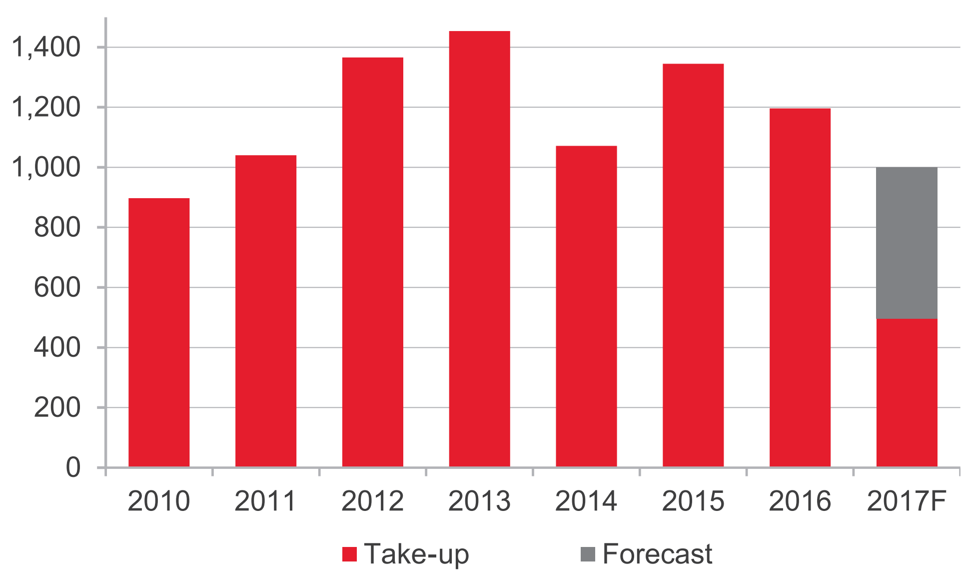
In the Moscow region, in Q2 2017, the take-up figure showed better results than in Q1 2017. The indicator managed to overcome a two-fold lag from 2016. In H1 2017, the total volume of lease and sale transactions was 496,000 sq m, which is 25% lower than the same indicator in 2016. (30, 31 ▶)

30 ▶ NEW CONSTRUCTION, CLASSES A AND B, '000 SQ M



Source: Cushman & Wakefield

31 ▶ TAKE-UP, CLASSES A AND B, '000 SQ M

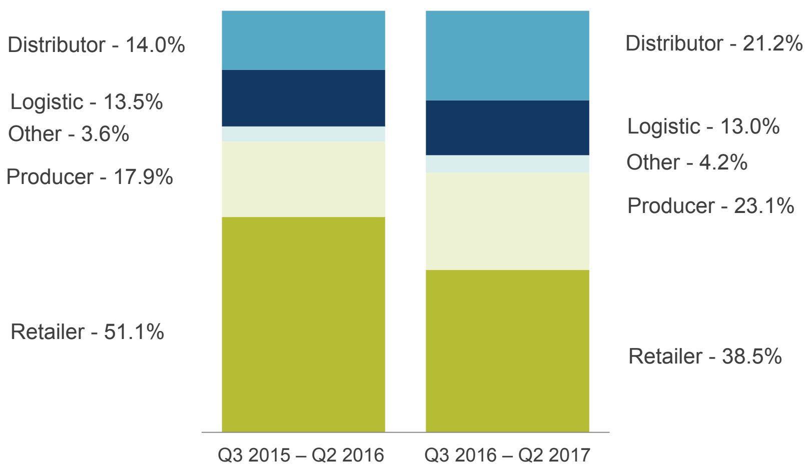


Source: Cushman & Wakefield

For the second year in a row, the demand for warehouse premises from the retail segment is decreasing. Compared to 2015, the share of deals with retailers declined from 50% to less than 40% in 2017. Meanwhile, there is a steady increase in demand for warehouse space from manufacturing companies and distributors – the share is 23% and 21% respectively.

At the beginning of 2017, the demand from food retailers decreased from 33% to 22%, meanwhile the demand from other segments increased. (32 ▶)

32 ▶ TAKE-UP STRUCTURE



Source: Cushman & Wakefield

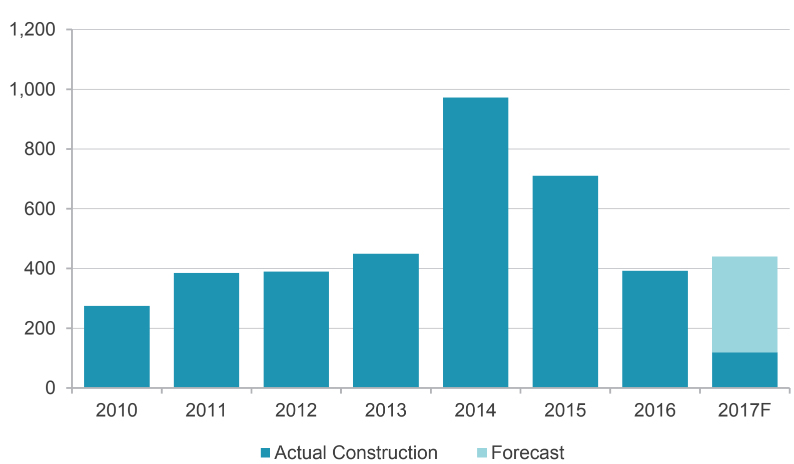
NEW CONSTRUCTION AND DEMAND. REGIONS

In H1, 120,000 sq m of quality warehouse space was constructed – down 60% year-on-year.

420,000 sq m of warehouse space will be added to the market – 10% higher than the last year indicator.

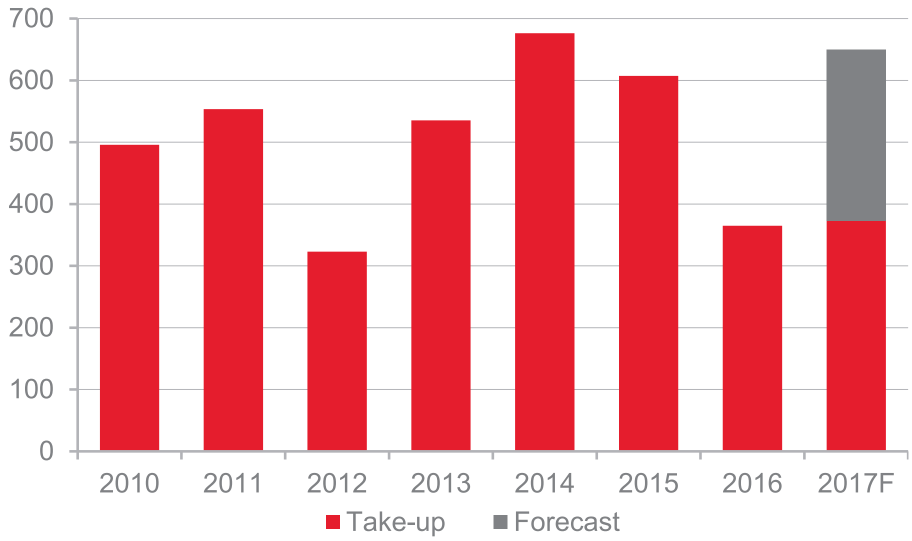
In the regions, the demand for warehouse premises is strong. In H1 2017, the transaction volume was higher than the 2016 annual indicator. It is possible that a record high take-up will be reached in 2017. (33, 34 ▶)

33 ▶ NEW CONSTRUCTION, CLASSES A AND B, '000 SQ M



Source: Cushman & Wakefield

34 ▶ TAKE-UP, CLASSES A AND B, '000 SQ M

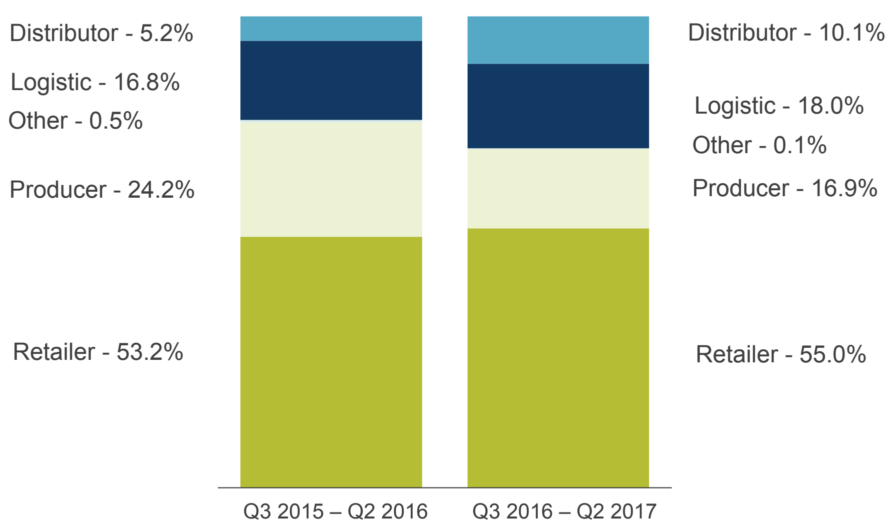


Source: Cushman & Wakefield

In the regions, large federal retailers are stimulating the development of logistics. For the third year in a row, the demand is mainly supported by retail chains. The share of retailers in the total volume of transactions is more than 50%. However, the regional market is not always able to meet the requests; there are some regions where quality warehouse schemes are not present, so sometimes a federal operator can become a warehouse developer.

In the regions, food retailers are the largest warehouse consumers – their share in the take-up comprises 30-40%. (**35** ▶)

35 ▶ TAKE-UP STRUCTURE



Source: Cushman & Wakefield

NEW CONSTRUCTION. MOSCOW AND REGIONS

PROJECT	HIGHWAY	REGION	DISTANCE FROM CITY, KM	TOTAL AREA, `000 SQ M	DELIVERY
FM Logistic Electrougli	Gorkovskoe	Moscow	29	50	Q1
Mikhailovskaya Sloboda	Novoryazanskoe	Moscow	20	46,97	Q2-3
Technopark Uspenskiy	Gorkovskoe	Moscow	44	48,23	Q2
LK-Vnukovo II	Kievskoe	Moscow	17	49,18	Q2
Logopark Synkovo	Simfeloropolskoe	Moscow	28	13,3	Q2
SK Oktavian	Toksovskoe	St. Petersburg	18	18,11	Q1
A Plus Park Perm	Krasnokamskaya road	Perm	19	26,37	Q2
Aviapolis Yankovskiy	Vladivostok – port Vostochniy	Vladivostok	48	46,82	Q1, Q3
A Plus Park Kazan	Mamadyshskiy trakt	Kazan	3	58,31	Q3-4

Source: Cushman & Wakefield

Hospitality – Moscow hotels in Q2 2017

The upscale segment demonstrated a slightly positive trend in rouble ADR (average daily rate) compared to Q2 2016 and showed a 1% increase (RUB 12,614). Rouble RevPAR (revenue per available room) vice versa showed -3% decrease and was RUB 8,049. US dollar figures of ADR increased by 20% and totalled USD 218 along with US dollar RevPar, which rose by 15% (USD 139). The overall occupancy decreased by 1% (64%).

Business hotels showed the following results in January-June 2017: US dollar RevPAR increased by 16% (USD 72) which was composed of a 1% occupancy increase (71%) and a 14% increase in ADR nominated in US dollars (USD 101). The rouble RevPAR decreased by 2% (RUB 4,143) in line with 4% ADR drop (RUB 5,822).

A decrease in indicators was observed in the midscale segment. ADR and RevPAR nominated in roubles dropped by 13% and 14% respectively amounting to RUB 3,841 and RUB 2,812. The US dollar ADR increased by 3% (USD 66), so did RevPAR which rose by 1% (USD 49). Overall occupancy decreased by 1% (73%).

The economy segment of Moscow hotels, which is mostly represented by Soviet-era objects showed ADR in the amount of RUB 2,189 for the six months of 2017 (6% decrease as compared to the corresponding period of 2016). Occupancy demonstrated 5% growth (58%) resulting in 3% increase in RevPAR – RUB 1,262.

Average occupancy across all market segments of Moscow hotels dropped by 3% (67%) as compared to the same period of 2016. During Q2 2017, US dollar ADR and RevPER decreased by 5% and 9% respectively (USD 106 and USD 70). At the same time, ADR nominated in roubles decreased by 20% amounting to RUB 6,119 along with RevPAR which demonstrated 23% decrease (RUB 4,068).

Comparing the results of Q1 2017 to the previous year, we can still observe the US dollar extreme growth unlike rouble figures which started showing a downshifting trend. This might be explained by the USD/RUB exchange rate drop by 18% in January-June 2017 compared to the corresponding period in 2016. Moreover, such difference in indices may have also occurred because all average rates are now calculated using a larger set of hotels than last year, and the average figures in 2017 are calculated including the economy segment.

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

• The gap between the upscale and midscale segments was USD 90/RUB 5,237 compared to USD 73/RUB 4,956 in the same period of 2016.

• The difference in RevPAR between upscale and business hotels changed to USD 67/RUB 3,906 vs 2016 results (USD 59/RUB 4,018).

36 ▶ HOTELS OPENED IN JANUARY-JUNE 2017 IN MOSCOW

Name	Number of rooms	Address	Class
Moss Club House	31+13 apartments	10/4 Krivokolenny Lane	5 stars
Hilton Garden Inn Krasnoselskaya	292	12a Verkhnyaya Krasnoselskaya Street, Bldg 4	3 stars
Park Inn Izmaylovo	109	10a Nikitinskaya Street	3 stars
Ibis Oktyabrskoe Pole	240	2/5 Marshal Rybalko Street	3 stars
Ibis Budget Panfilovskaya	114	2/5 Marshal Rybalko Street	2 stars
Vega Izmaylovo (renovation)	997	71 Izmaylovskoe Highway, Bldg 3B	3 stars
Total: 6 hotels	**1,783 rooms, 13 apartments**		

Source: EY database, open sources, operators' data

Hotels opened in Q1 2017:

• A new Moss Club House with apartments and a boutique hotel opened in Moscow at 10/4 Krivokolenny Lane, in February 2017. The house offers 13 apartments and 31 hotel rooms. The developer of the project is Adwill Management, the amount of project investments in acquisition and reconstruction is RUB 1.5 billion (USD 25.7 million).

• Hilton Worldwide announced the opening of the new Hilton Garden Inn Krasnoselskaya Hotel in Moscow in March 2017. The hotel is located at 11a Verkhnyaya Krasnoselskaya Street, Bldg 4 and offers 292 rooms, a restaurant, a shop, an event hall, four meeting rooms, a fitness centre, a laundry and parking.

Hotels opened in Q2 2017:

• Carlson Rezidor Hotel Group announced the opening of Park Inn Izmaylovo Hotel in Moscow near Izmaylovo Park in April 2017. The hotel opened in a building where Dedeman Hotel operated previously. The Dedeman chain left the Russian market in 2016. Park Inn Hotel offers 109 rooms, a café, a bar, a conference hall, a mini-market, a terrace and parking.

• Accor Hotels opened Ibis and Ibis Budget Hotels at 2/5 Marshal Rybalko Street in Moscow in June 2017. Ibis Oktyabrskoe Pole offers 240 rooms, Ibis Budget Panfilovskaya – 114 rooms. The infrastructure of the complex includes a restaurant and three conference halls.

• A large-scale renovation of the Vega Izmaylovo Hotel room stock and conference halls was finished in June 2017. The renovation was initiated before FIFA World Cup 2018. Now the hotel offers 997 rooms, the infrastructure also includes 4 restaurants, 17 conference halls, a fitness center and a beauty salon. The hotel is located at 71 Izmaylovskoe Highway, Bldg 3B.

We expect the following brand-name hotels to open in 2017: (37 ▶)

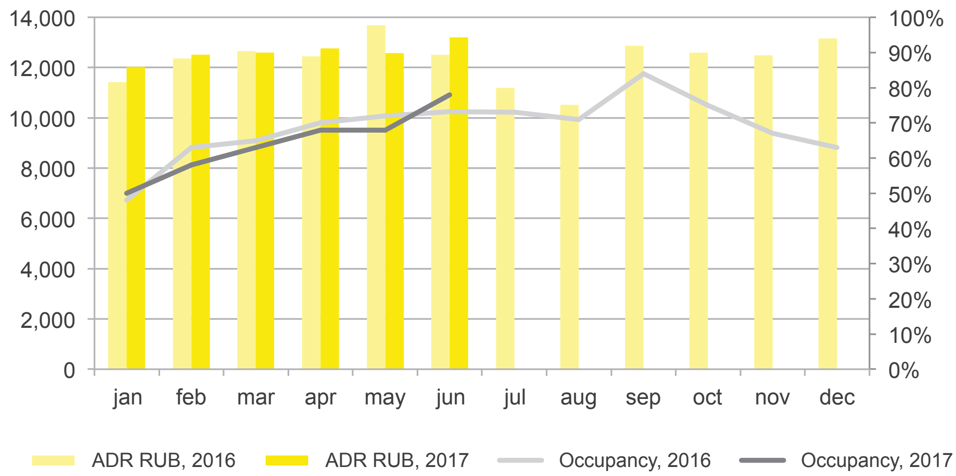
37 ▶ FUTURE HOTELS ANNOUNCED FOR OPENING IN MOSCOW IN 2017

Name	Number of rooms	Address	Class
Moscow			
Hyatt Regency Moscow Petrovsky Park*	298	36 Leningradsky Avenue	4 stars
DoubleTree by Hilton Vnukovo Airport*	432	Vnukovo Airport	4 stars
Ramada H&S Moscow Greenwood Park	376	69 km MKAD, Krasnogorsk District	4 stars
Four Points by Sheraton Moscow Vnukovo Airport	250	8 Vnukovskaya Bolshaya Street	3 stars
Holiday Inn Express Moscow - Dubininskaya	243	Dubininskaya Street	2 stars
Mercure Neglinnaya	100	n/a	4 stars
Ibis Moscow Alekseevskaya	180	n/a	3 stars
Radisson Olympiyskiy Hotel Moscow	340	1 Olimpiysky Passage	5 stars
Moscow region			
Hilton Mozhaysk Borodino Hotel & SPA	160	Zarechye Village, Mozhaysky district	5 stars
Ibis Domodedovo	158	Shishkino Village	3 stars
Total: 10 hotels	**2,537 rooms**		

*These hotels were to be opened in 2016, but remained at the stage of development as of 2017.

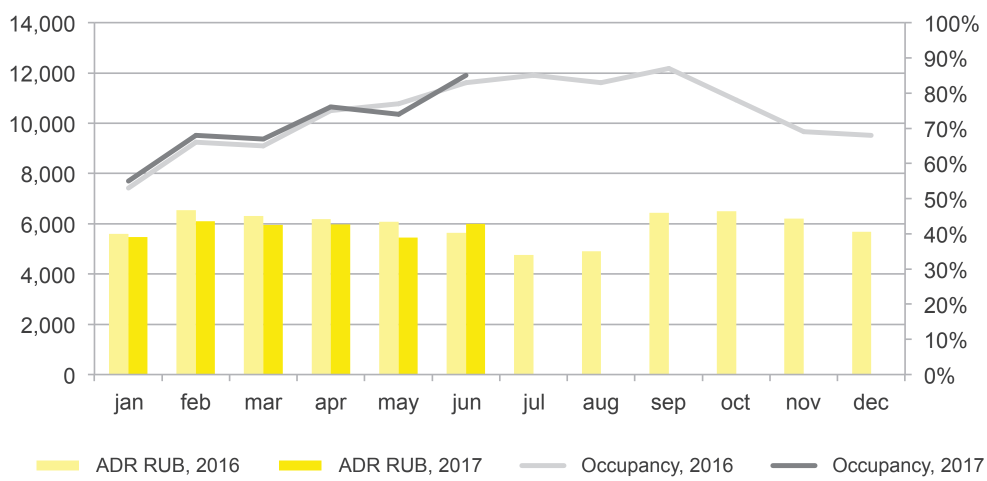
Source: EY database, open sources, operators' data

38 ▶ 5-STAR HOTELS: ADR* (RUB) AND OCCUPANCY DYNAMICS, 2017 VS 2016



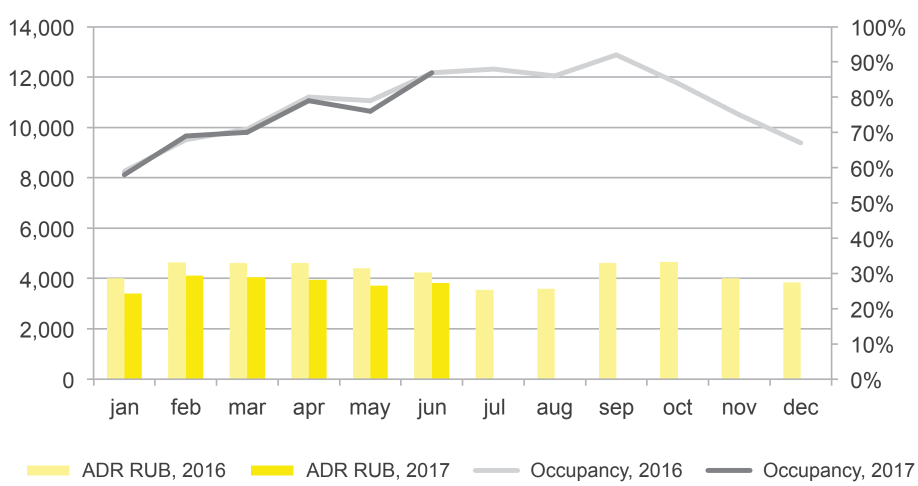
* average daily rate
Source: EY analysis

39 ▶ 4-STAR HOTELS: ADR* (RUB) AND OCCUPANCY DYNAMICS, 2017 VS 2016



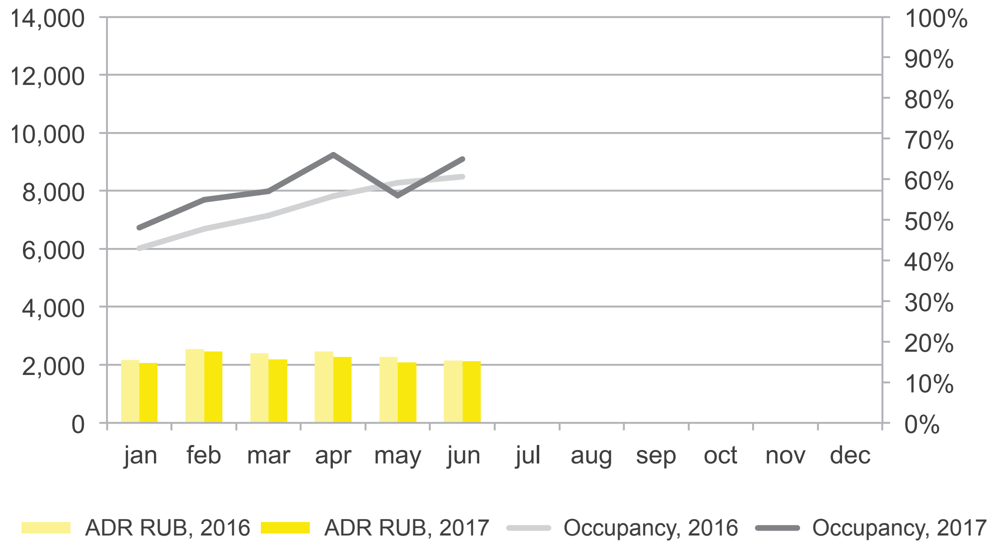
*average daily rate
Source: EY analysis

40 ▶ 3-STAR HOTELS: ADR* (RUB) AND OCCUPANCY DYNAMICS, 2017 VS 2016



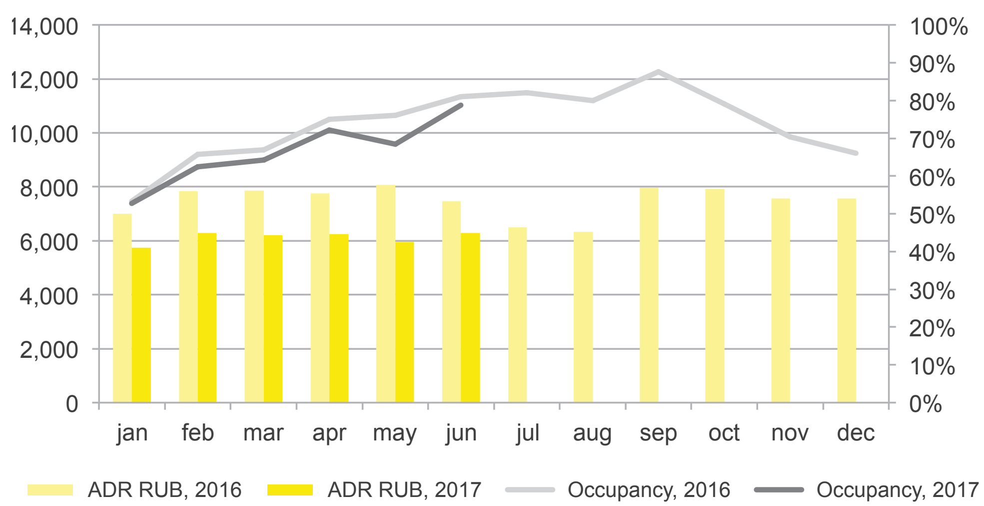
*average daily rate
Source: EY analysis

41 ▶ 2-STAR HOTELS: ADR* (RUB) AND OCCUPANCY DYNAMICS, 2017 VS 2016



*average daily rate
Source: EY analysis

42 ▶ AVERAGE MARKET ADR* (RUB) AND OCCUPANCY DYNAMICS, 2017 VS 2016



*average daily rate
Source: EY analysis

43 ▶ OPERATIONAL INDICES DYNAMICS

	January-June 2017 (USD/RUB)	January-June 2016 (USD/RUB)	January-June 2017 / January-June 2016, %	2016
5 stars				
Occupancy	64%	65%	-1%	69%
Average daily rate (ADR)	USD 218/RUB 12,614	USD 183/RUB 12,514	20% / 1%	USD 187/RUB 12,325
Revenue per available room (RevPAR)	USD 139/RUB 8,049	USD 121/RUB 8,243	15% / -2%	USD 129/RUB 8,486
4 stars				
Occupancy	71%	70%	1%	74%
ADR	USD 101/RUB 5,822	USD 88/RUB 6,058	14% / -4%	USD 89/RUB 5,902
RevPAR	USD 72/RUB 4,143	USD 62/RUB 4,225	16% / -2%	USD 66/RUB 4,357
3 stars				
Occupancy	73%	74%	-1%	78%
ADR	USD 66/RUB 3,841	USD 64/RUB 4,424	3% / -13%	USD 64/RUB 4,234
RevPAR	USD 49/RUB 2,812	USD 48/RUB 3,287	1% / -14%	USD 50/RUB 3,306
2 stars				
Occupancy	58%	53%	5%	no data
ADR	USD 38/RUB 2,197	USD 34/RUB 2,335	12% / -6%	no data
RevPAR	USD 22/RUB 1,269	USD 18/RUB 1,234	22% / 3%	no data
Average				
Occupancy	67%	70%	-3%	74%
ADR	USD 106/RUB 6,119	USD 112/RUB 7,665	-5% / -20%	USD 113/RUB 7,487
RevPAR	USD 70/RUB 4,068	USD 77/RUB 5,252	-9% / -23%	USD 82/RUB 5,383

Source: Smith Travel Research, EY analysis and forecast

Moscow Housing Market

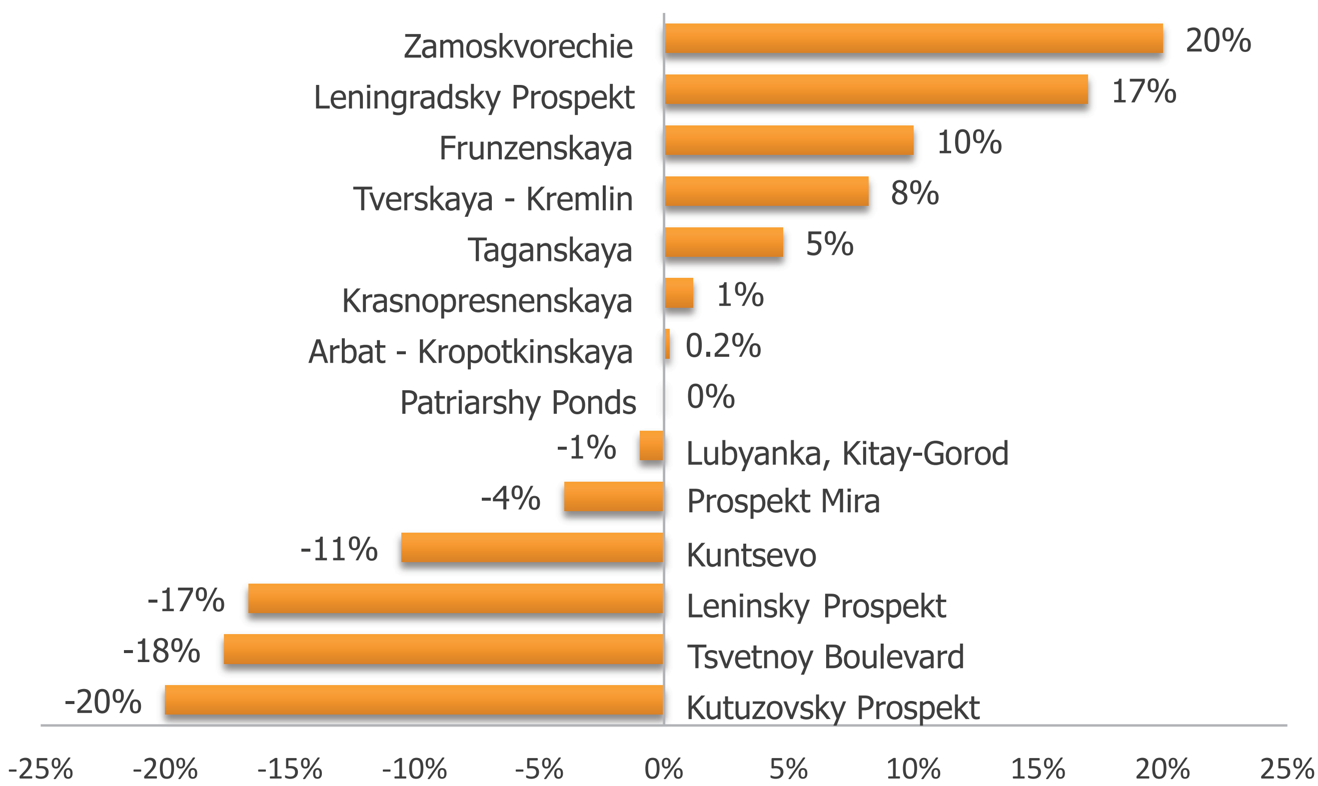
At present, the choice of high-budget rental apartments is wide and varied, and the volume of supply is at its highest point for the past year. At the same time, amid landlords' increased activity, the number of requests from potential tenants is also growing. This positive trend is traditional for this period and connected with the fact that many tenants, especially families with children, are trying to solve the rental housing issue by August or early September, before the start of the business season and academic year.

SUPPLY

Over the past three years, the volume of high-budget apartments for rent in Moscow has increased by approximately a quarter (26%).

Over the past year, the largest increase in supply has been observed in three main districts: Zamoskvorechie (+20%), Leningradsky Prospekt (+17%) and Frunzenskaya (+10%). A noticeable decrease in availability of high-budget apartments from June 2016 was found in Kutuzovsky Prospekt (-20%) and Tsvetnoy Boulevard (-18%). (44 ▶)

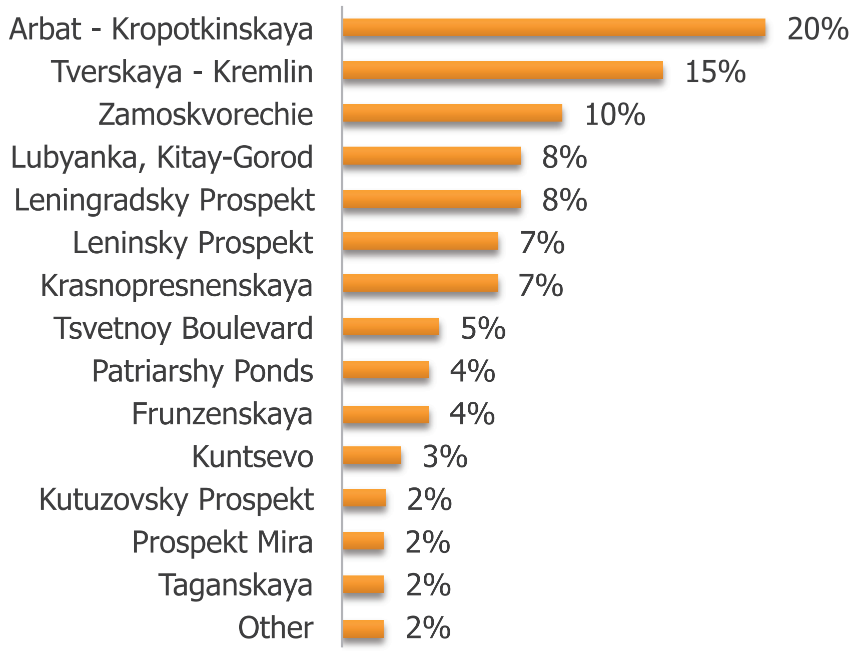
44 ▶ SUPPLY VOLUME GROWTH BY AREA, H1 2017



Source: Intermark Relocation

The TOP 3 districts in terms of supply are Arbat-Kropotkinskaya area, with 20% of market share, Tverskaya-Kremlin and Zamoskvorechie areas, with 15% and 10% of all lots, respectively. (**45** ▶)

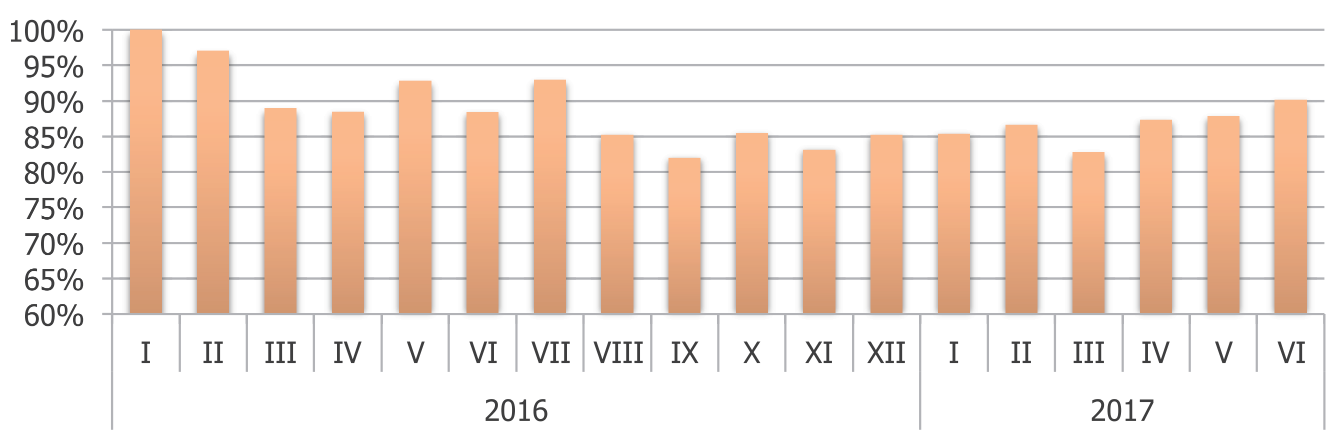
45 ▶ ANALYSIS OF THE MOST POPULAR AREAS IN TERMS OF SUPPLY



Source: Intermark Relocation

Thus, in June-early July 2017, we see the maximum volume of high-budget apartments for rent in Moscow for the past year. The last time a comparable volume of supply was registered in July 2016. (**46** ▶)

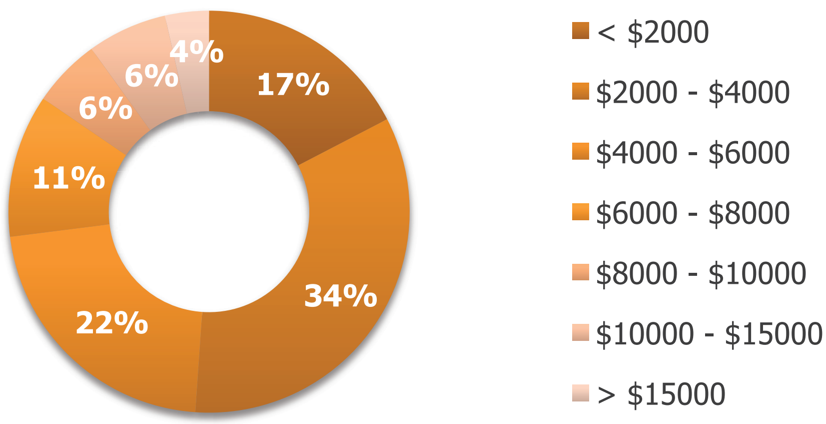
46 ▶ DYNAMICS OF THE SUPPLY OF MOSCOW'S PRIME RENTAL MARKET (JANUARY 2016 – 100%)



Source: Intermark Relocation

At the present moment, the most expensive apartments for rent are offered in the following districts: Arbat-Kropotkinskaya (USD 6,580 per month), Krasnopresnenskaya and Patriarshiye Ponds – USD 6,400 and USD 5,890 per month, respectively. (**47** ▶)

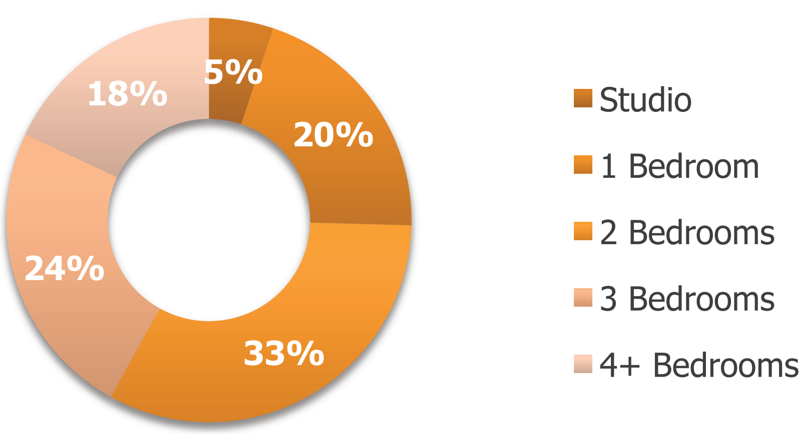
47 ▶ SUPPLY ANALYSIS OF EXPAT HOUSING IN MOSCOW IN TERMS OF RENTAL BUDGET



Source: Intermark Relocation

Two- and three-bedroom apartments are the most common options on the high-budget rental market in Moscow. The volume of supply of such objects is more than half of all exhibited lots (57%), distributed in almost equal proportions – 33% and 24%, respectively. At the same time, the share of studios for rent is minimal, at only 5% of the total supply. (**48** ▶)

48 ▶ SUPPLY ANALYSIS OF EXPAT HOUSING IN MOSCOW IN TERMS OF NUMBER OF ROOMS



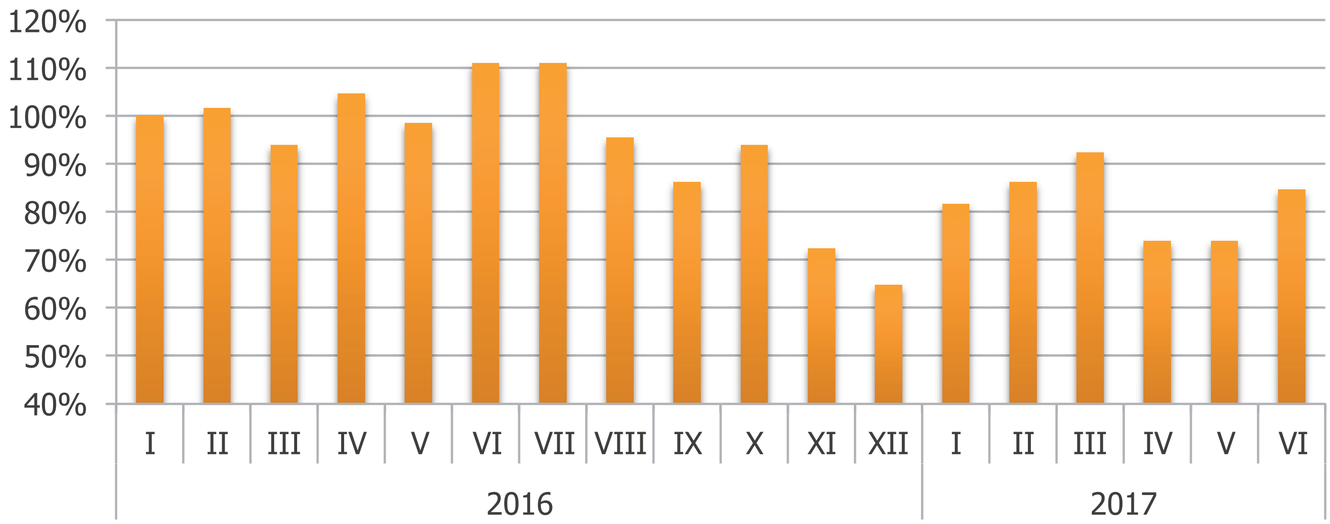
Source: Intermark Relocation

DEMAND

In June 2017, demand from potential tenants was 8% higher than in the same period two years earlier.

The volume of demand from tenants has increased by 15% since the end of 2016 to the present day (comparing the period from November to December 2016 and May to June 2017). (**49**)

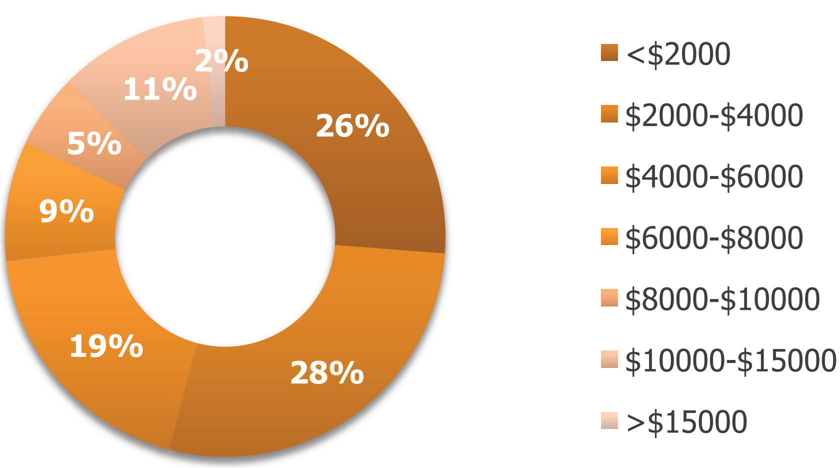
49 DYNAMICS OF THE DEMAND OF MOSCOW'S PRIME RENTAL MARKET (JANUARY 2016 – 100%)



Source: Intermark Relocation

The Leningradsky Prospekt is traditionally the most popular district in the high-budget rental market in Moscow. Since the beginning of the year, apartments in this area have been of interest to almost 16% of all potential tenants. The second most popular location for rent is Arbat-Kropotkinskaya, with 10% of all requests. Compared to the same period last year, the average tenant budget has increased – USD 4,716 versus USD 3,650 in 2016. More than a quarter (28%) of all tenants are interested in renting an apartment at around USD 2,000-4,000 per month. (**50**)

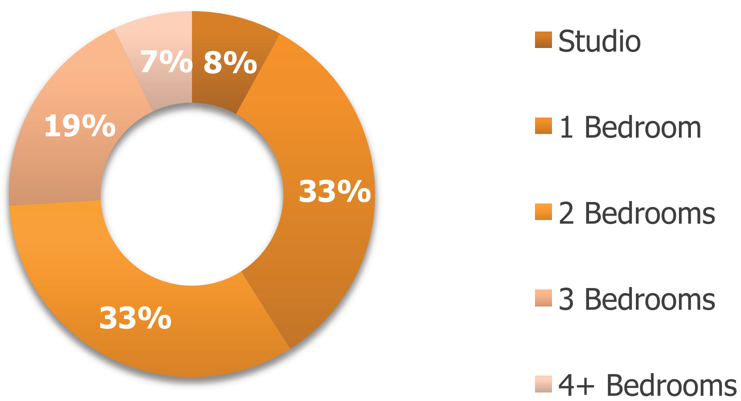
50 DEMAND ANALYSIS IN TERMS OF RENTAL BUDGET



Source: Intermark Relocation

As of June 2017, apartments with one and two bedrooms have been the most popular among tenants since the beginning of the year. (51 ▶)

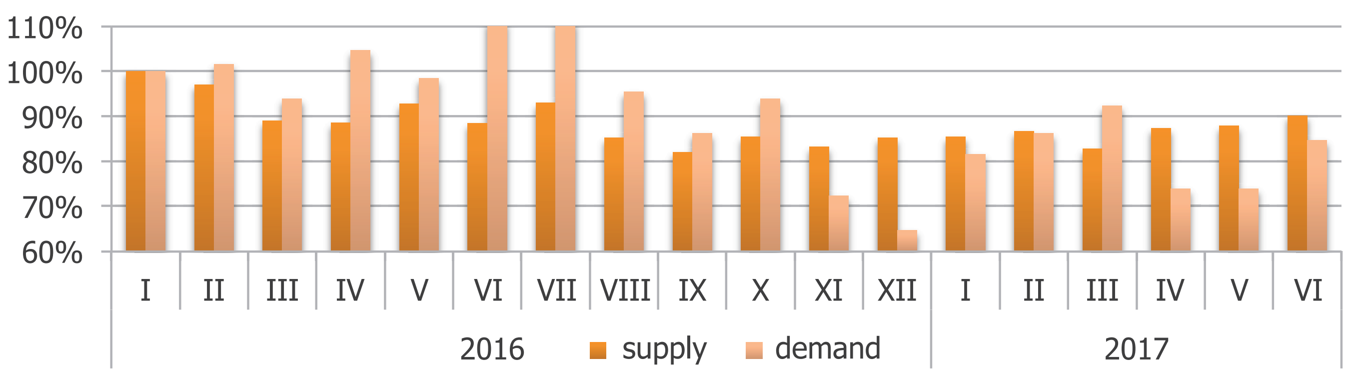
51 ▶ DEMAND ANALYSIS IN TERMS OF NUMBER OF ROOMS



Source: Intermark Relocation

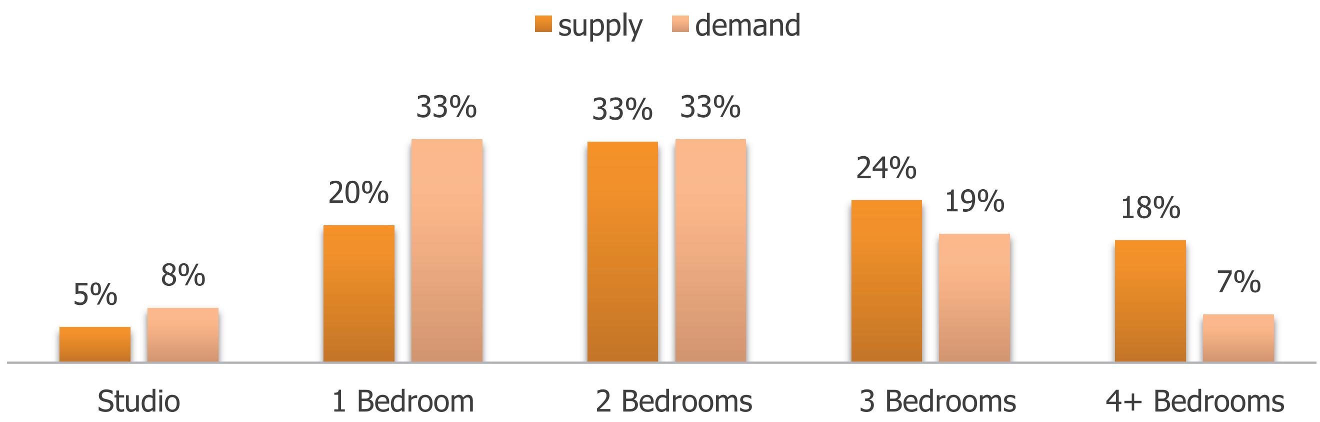
SUPPLY-DEMAND CORRELATION

52 ▶ DYNAMICS OF THE SUPPLY AND DEMAND OF MOSCOW'S PRIME RENTAL MARKET (JANUARY 2016 – 100%)



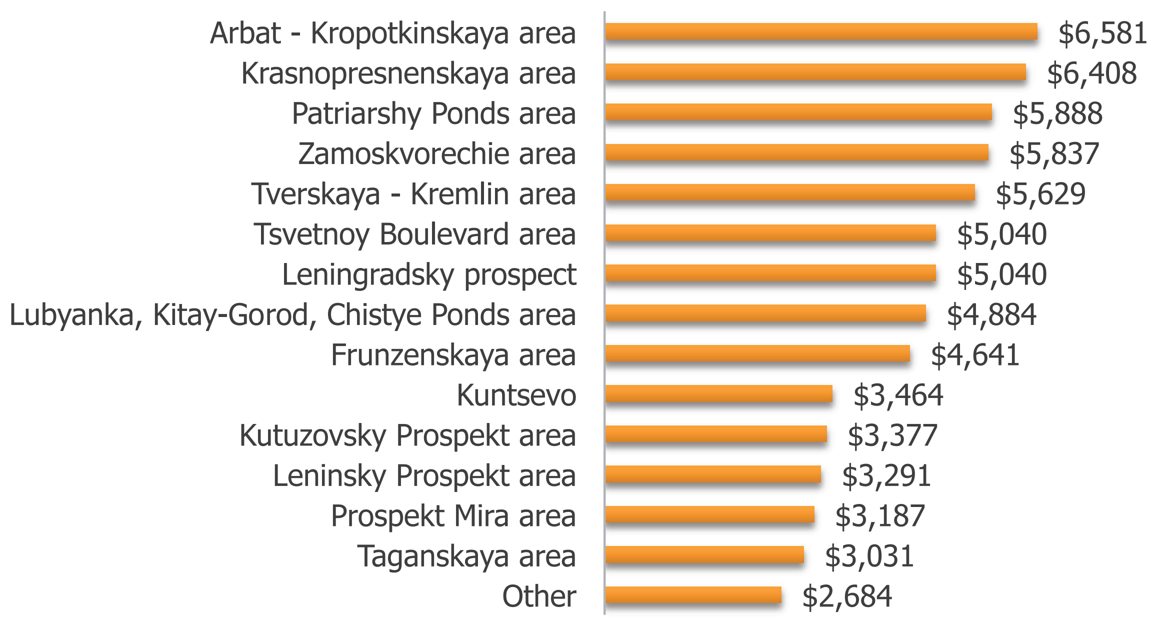
Source: Intermark Relocation

53 ▶ SUPPLY AND DEMAND ANALYSIS OF EXPAT HOUSING IN MOSCOW IN TERMS OF RENTAL BUDGET



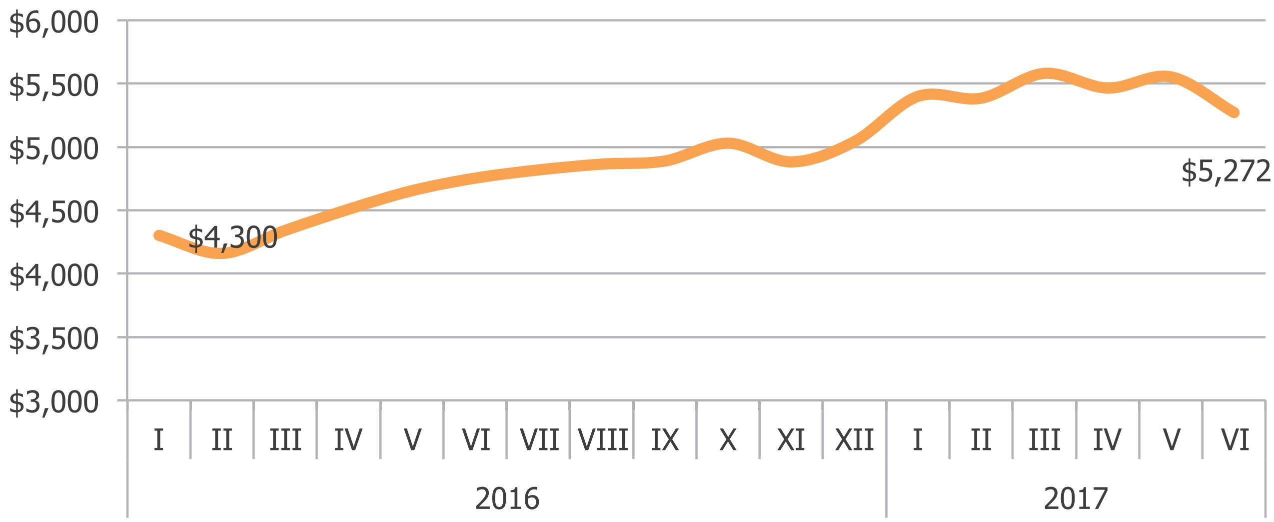
Source: Intermark Relocation

54 ▶ AVERAGE BUDGET STRUCTURE OF SUPPLY BY AREA (JUNE 2017)



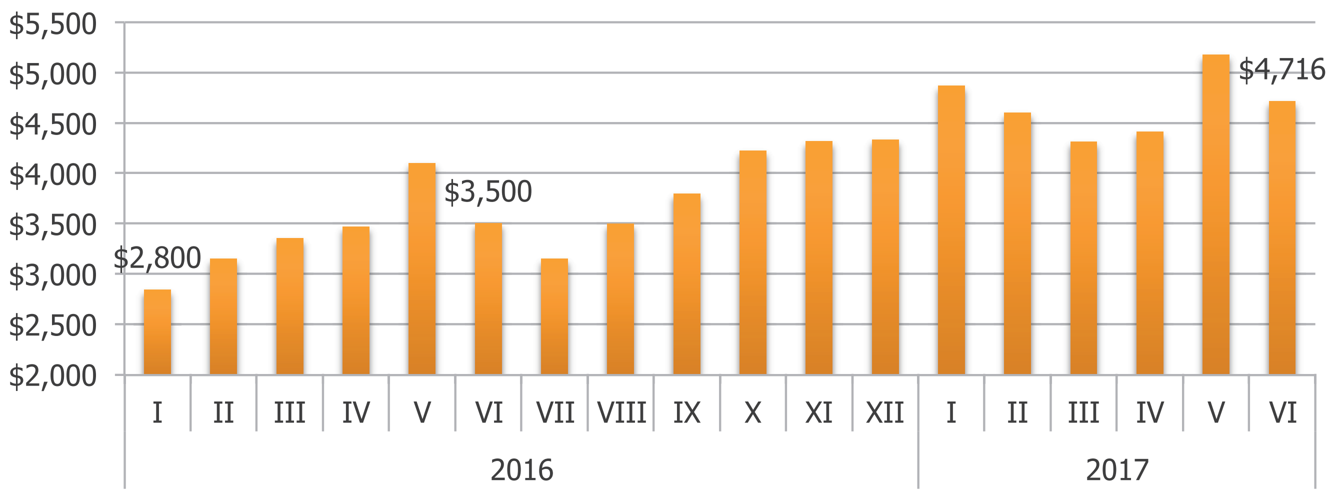
Source: Intermark Relocation

55 ▶ DYNAMICS OF THE AVERAGE RENTAL RATES IN MOSCOW'S PRIME RENTAL MARKET



Source: Intermark Relocation

56 ▶ DYNAMICS OF THE AVERAGE ASKING PRICE FOR TENANCY IN MOSCOW'S PRIME RENTAL MARKET



Source: Intermark Relocation

57 ▶ ANALYSIS OF THE AVERAGE ASKING PRICE/NUMBER OF BEDROOMS/CLASS

Area	Arbat-Kropotkinskaya, Patriarshy Ponds, Tverskaya, Lubyanka-Kitay-Gorod, Zamoskvorechie		Close to international schools (Leningradsky Prospekt, Kuntsevo)	
Description	Business class	Elite class and Premium class	Business class	Elite class and Premium class
1 bedroom	$1,400 - $2,500	$2,000 - $3,000	$1,200 - $3,000	$1,400 - $3,500
2 bedrooms	$1,800 - $2,700	$3,200 - $6,500	$1,100 - $3,000	$2,500 - $5,500
3 bedrooms	$2,700 - $3,500	$4,200 - $8,500	$2,000 - $3,500	$4,200 - $7,500
4 bedrooms	$3,700 - $6,000	$6,500 - $9,000	$3,500 - $5,000	$6,000 - $8,300
5+ bedrooms	$7,000 - $10,000	$9,000 - $11,000	$5,500 - $9,000	$9,000 - $10,000

Source: Intermark Relocation

St. Petersburg market overview

Office market

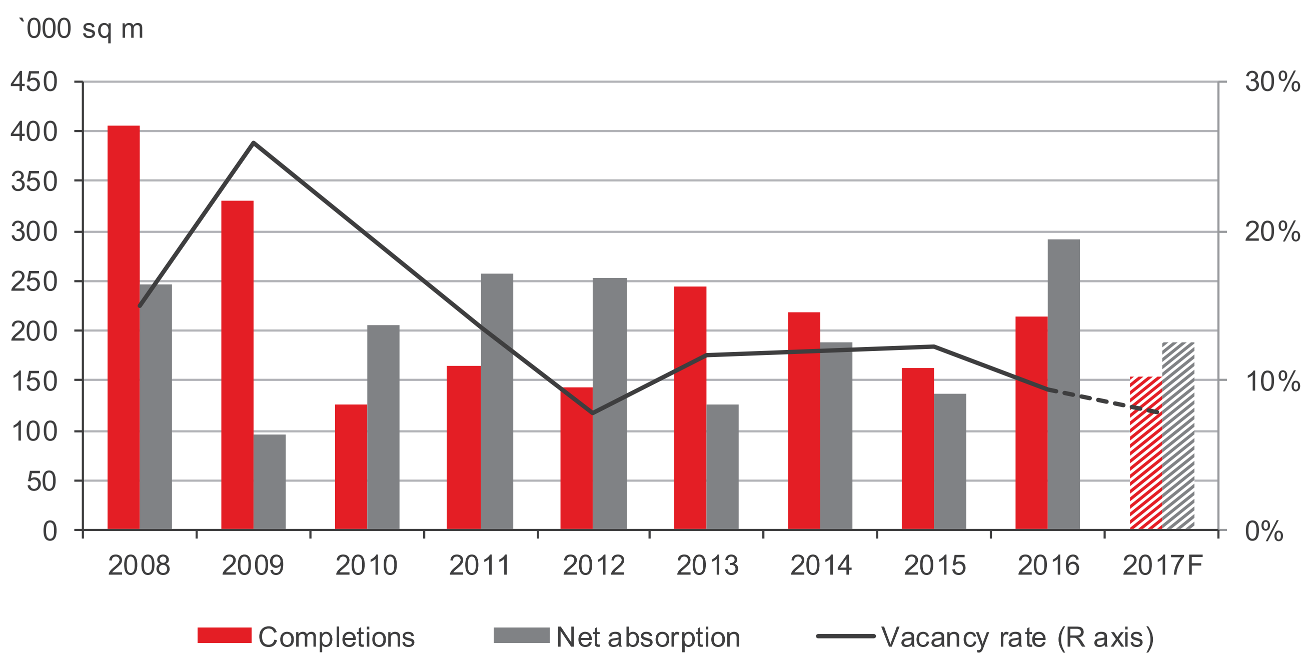
In Q2 2017, only one office centre (Nevka, Class A, 3,100 sq m GLA) was delivered. This is the lowest quarterly completion level on record. A number of projects were postponed to H2 2017. Completions in 2017 are expected to be 29% lower YoY at about 153,000 sq m.

Due to the low new supply, net absorption has also declined. In Q2 2017, it totalled 37,020 sq m, 45% lower YoY. In H1 2017, the net absorption was down 48% YoY.

In Q2 2017, the average vacancy rate dropped by 0.8 ppt to 7.8%. In Class A, it reached 5.0% in Q2 2017 (down by 0.9 ppt QoQ), in Class B 9.0% (-0.7 ppt QoQ). We expect the vacancy rate to fluctuate around 7.5-8% in H2 2017 due to new completions.

In Q2 2017, rental rents increased by 0.6% in Class A, to RUB 1,647/sq m/month, and by 0.9% in Class B, to RUB 1,177/sq m/month (including VAT and operating expenses). The growth was driven by declining availability. (58 ▶)

58 ▶ MARKET BALANCE



Source: JLL

Retail market

The St. Petersburg quality shopping centre stock comprises 58 centres with the total leasable area of 2.25 million sq m. There are no shopping centres announced for delivery until 2018.

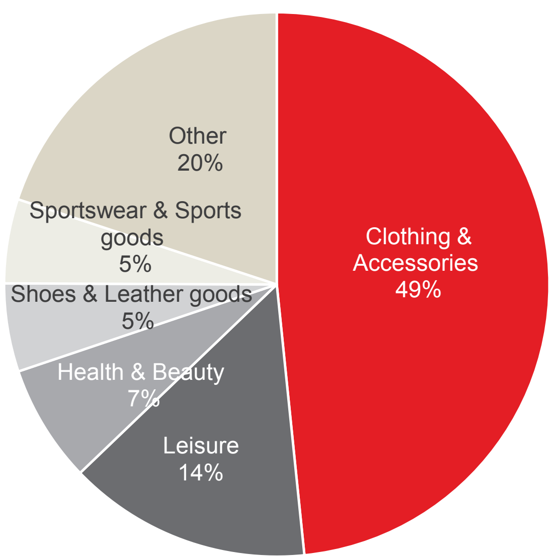
The overall vacancy rate increased slightly in Q2 2017 by 0.1 ppt, to 5.7%. The most visible decline was in the East, by 0.8 ppt QoQ. The highest increase was in the North, by 0.7 ppt QoQ.

The total volume of opened clothing stores exceeded the area of closed ones in Q2 2017 by 18%. The share of clothing & accessories stores among the opened tenants has reached a maximum level in the last two years – 49%.

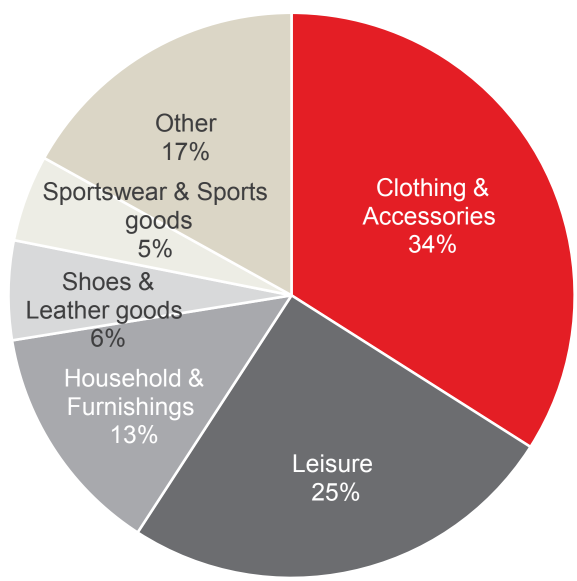
Prime base rents in quality shopping centres have not changed and amounted to RUB 65,000-70,000/sq m/year (excluding VAT and operating expenses). (59 ▶)

59 ▶ TENANT CHANGES IN SC IN Q2 2017

OPENED STORES IN Q2 2017, SQ M



CLOSED STORES IN Q2 2017, SQ M



Source: JLL

Street retail market

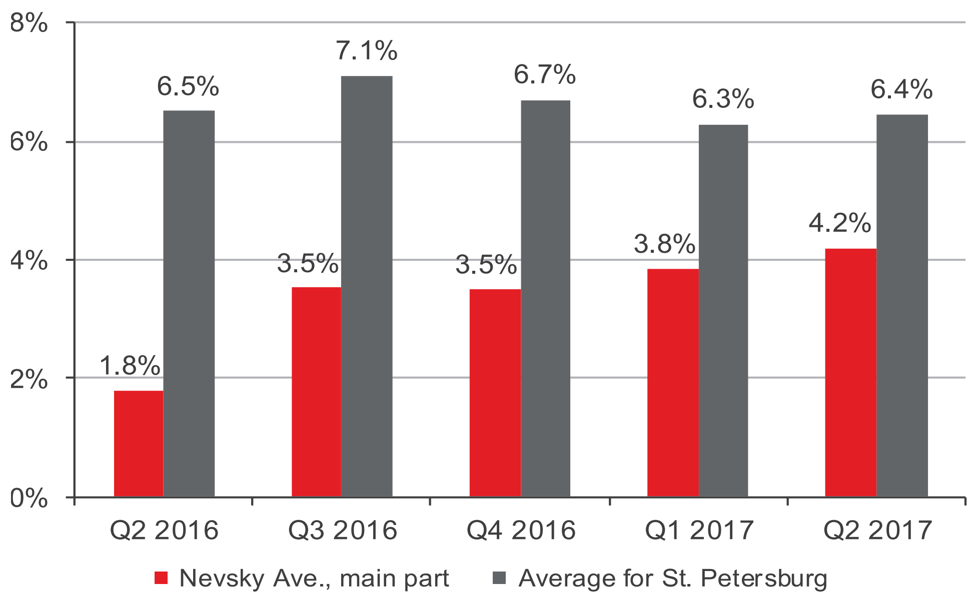
In Q2 2017, the average vacancy level on the main corridors increased by 0.1 ppt to 6.4%. The largest increase was observed on Rubinshtein St., by 4.4 ppt to 5.9%, and Sredniy Ave., by 2.7 ppt to 5.3%.

The total number of opened stores in Q2 2017 was almost equal to the number of closed, exceeded the latter by just 2%. The largest increase was observed in the Health & Beauty segment due to the development of pharmacies.

The share of cafés and restaurants on the main street retail corridors reached the highest quarterly share among opened stores in the last two years, 40%. Also, the share of fashion retailers has reached its peak of 18%.

In Q2 2017, prime rents typical for the main section of Nevskiy Ave. (before Vosstaniya Sq.) remained stable at RUB 13,000/sq m/month (including VAT). (**60** ▶)

60 ▶ VACANCY RATE DYNAMICS ON THE MAJOR STREET RETAIL CORRIDOR



Source: JLL

Warehouse market

In Q2 2017, two quality warehouse complexes were delivered to the market with a total area of 25,000 sq m. Overall in 2017, about 59,000 sq m will be built, the lowest level since 2012.

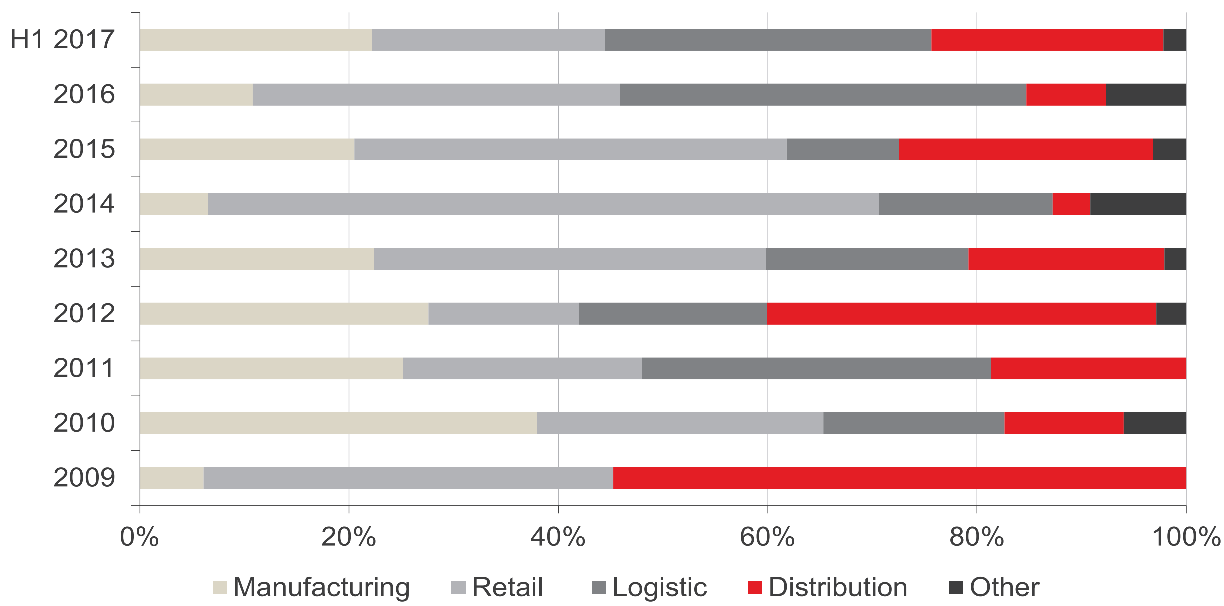
The lack of new supply affects the vacancy rate dynamics. In Q2 2017, the vacancy rate declined by 0.4 ppt, to 6.1%. By the end of 2017, we expect a decline to 5.9%.

In 2016, the asking rental rates for quality warehouse complexes declined to RUB 400-450 per sq m/month (including OPEX and VAT). We do not expect significant further rental changes in 2017.

The total take-up reached maximum values of 95,300 sq m in Q2 2017 and 150,100 sq m in H1. Current warehouse market conditions encourage tenant relocation to other quality complexes in order to improve the commercial terms.

In 2017, the high volume of warehouse deals coincides with low net absorption, which is typical for a recessionary period. The net absorption reached 33,500 sq m in Q2 2017 and 16,900 sq m in H1. (**61 ▶**)

61 ▶ WAREHOUSE DEMAND BREAKDOWN BY COMPANY TYPE



Source: JLL

Hot Topic:

Cloud services: new business models for VAC system manufacturers

Alexander Nevrovskiy
Head of Marketing in Building Technologies, Siemens LLC

In this article, we will talk about cloud services – special remote data banks that make such data available wherever you are and whichever type of device you are using to refer to them – as long as you have a web application installed (any browser).

WHAT ARE THE BENEFITS OF CLOUD SERVICES FOR VENTILATION AND AIR CONDITIONING (VAC) SYSTEM MANUFACTURERS?

Cloud services offer a number of advantages for VAC system manufacturers. First and foremost, they ensure a more transparent market: all systems sold and installed on site will be displayed on a map linked to exact coordinates. The Russian and global reality shows that part of the equipment is dispatched to installation specialists, and the end customer is not always known. The share of such 'invisible' customers may vary from manufacturer to manufacturer: companies with a 'project' approach know their customer more often than those working through installation, distribution companies and other agents.

In any case, a VAC system synchronised with the cloud service will be identified by the manufacturer via the monitoring system interface. The obvious advantage of this functionality for marketing and business development is search for new geographical sale segments.
Another significant benefit for VAC system manufacturers is remote commissioning. In other words, a technician does not have to actually visit the site. All work required – downloading of software, selection of application, customisation, etc. – can be performed by the specialist from the shop floor. Therefore, you will be able to significantly cut costs, which can either be used to increase revenue or market price competition.

The third unique feature changing your usual thinking is warranty service-based operation of systems sold. As with the commissioning process, warranty service of geographically remote sites is no longer expensive. You do not have to send an employee to the site and incur expenses in order to receive all data on the unit's current status, its operation modes that caused a warranty (non-warranty) case, and review error messages. The manufacturer's technician can get all the data for failure diagnosing and establishing its root cause directly from the shop floor, in the same familiar interface.

Moreover, post-warranty period can work just the same. Each installation with its recorded (log files stored in a cloud) history can be easily forecasted by the manufacturer with regard to operability and hub replacement. This gives you an opportunity to provide fee-based post-warranty service – both low-cost software updates and replacement of specific machines and hubs. Thus the latter, the manufacturing company's service specialist already knows which hub broke down, and which needs replacement as their life span is close to critical even before he/she arrives to the customer site. This allows you to immediately create an order for spare parts and carry out the service itself as soon as possible.

Convenience of remote support by local specialists working on site for the operator should be mentioned specifically. Instead of directly managing the entire system, the manufacturer's technician can also help (and train) a local specialist in terms of various peculiarities. The benefit of such training is that, for example, in Climatix IC cloud service, the manufacturer's representative can see on his/her display (in browser window) a full copy of the actual controller display demonstrating the local specialist's operations. And the specialist can also work with different displays – standard controller displays, remote panels, in-house modules. In any case their dialogue will be more efficient as both will be using the same interface: the first one – the actual interface, the other – the virtual one.

Furthermore, cloud technologies provide other new opportunities to VAC system manufacturers. API (special programming interface) facilitates transmission of any data from the cloud to any business accounting system, e.g. to 1C widely used in Russia. Thus, you can ensure full-scale digitalization of your business and make it predictable.

Moreover, API allows to transfer data to specifically developed applications (e.g. for phones) which will help you customise a standard cloud solution for your own needs.

OPPORTUNITIES FOR ON-SITE OPERATION SERVICE

What does a VAC system operation service get from it besides prompt response of the manufacturer's service? Here there's also a number of quite critical financial business model points.

First of all, as mentioned above, the VAC manufacturer has access to the entire ventilation unit history, including its previous operation modes. Together with the operator it can optimise inefficient modes that will automatically affect heat costs.

Interface displaying system operation features (temperatures for various sections, fan rotation speed, humidity, pressure, etc.) can be easily adjusted to the company's needs.

The planner will help you ensure more power-efficient operation of the unit: neatly adjusted modes will reduce power consumption to 30% during the day. The planner can also be accessed from the cloud interface.

The emergency and abnormality alert system allows not only a prompt reaction to events, but also prompt involvement of all stakeholders. For this purpose, automatic e-mails are distributed under a specific algorithm to pre-defined persons. Among other things, you can select a service company. However, as already noted, it will keep up-to-date through its own monitoring.

WHAT ABOUT SAFETY?

Safety is one of the most frequently questions asked by the customers. In particular, building owners and maintenance organisations are most interested in the following: could an external user access our systems and start controlling indoor climate?

As a rule, all state-of-the-art cloud solutions are tamperproof. As for web dispatching Synco IC and Climatix IC, data between on-site VAC system and the cloud, where all data are stored, are transferred via a securely encrypted protocol. The cloud itself is secured in accordance with the global safety standards, regardless of the cloud service provider.

THERE IS MORE TO COME

Finally, it should be said that innovative digital add-ons for VAC systems not only change business models of market players, but also can attract new ones previously not engaged in engineering. All information collected in engineering systems every second means data, and considering the complexity of the systems and their constant operation this already means big data. So-called big data that can be analysed, enriched with third-party information (outside temperature, daylight hours, falls, number of visitors in the building, etc.) and further used for forecasting. But that is a topic for another article.

Hot Topic:

Unjustified tax benefit in real estate – what is on the tax authorities' agenda?

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As of August 2017, the 'unjustified tax benefit' concept, which was first formulated by the Plenum of the Supreme Arbitration Court at the end of 2006 in Ruling No. 53, will assume a codified form with the introduction of Article 54.1 of the Tax Code.

The above-mentioned Ruling was adopted as the judiciary's response to the absence in the tax law of clear provisions for addressing situations in which taxpayers understated their tax base as a result of unlawful actions and the abuse of rights.

Tax authorities have frequently referred to Ruling No. 53 in demonstrating both lack of due circumspection in choosing contractors and the lack of business purpose in particular transactions.

These amendments are quite general and are mainly aimed at setting in law the 'unjustified tax benefit' concept that has been extensively used. Given the main purpose and the wording of the amendments, it is reasonable to predict that the new Tax Code provisions, taken in combination with existing practice, may come to form one of the key reference points for the tax authorities in challenging taxpayers over tax obligations arising from transactions.

A considerable number of court cases relating to the receipt of unjustified tax benefit are cases in which the tax authorities have managed to identify tax schemes and requalify transactions based on their actual economic substance, resulting in the recalculation of tax obligations. There are a number of court cases where the tax authorities appeal to the receipt of unjustified tax benefit by real estate owners and developers.

Russian tax authorities tend to challenge companies of the real estate market based on, among other things, the following grounds:

• Intra-group loans were requalified as capital contributions.
• Interest deduction was challenged under the loan received by a company for acquisition of shares in another company with further merger of the two companies (debt push-down strategy).
• The contribution of immovable property to a company's capital and the subsequent sale of shares in that company (share deal) were treated as the sale of immovable property (asset deal).

REQUALIFICATION OF LOAN ARRANGEMENTS INTO CAPITAL CONTRIBUTIONS

Prior to 2017, a number of court cases were known in which the tax authorities challenged deduction of interest and foreign exchange losses on intra-group loans on the grounds that contributions to capital had been made under the guise of loan agreements[1].

[1] Determination No. VAS-5243/2014 of the Supreme Arbitration Court of 8 May 2014 on Case No. A40-18786/2013, Determination No. 305-KG14-5812 of the Supreme Court of 11 December 2014 on Case No. A40-141855/2013, Ruling No. F05-6830/2015 of the Arbitration Court of the Moscow District of 15 June 2015 on Case No. A40-115140/2014.

We know of at least two adverse rulings dated this year, which confirm the tax authorities' interest in reclassifying intra-group loans. For instance, in Ruling No. F10-960/2017 of the Arbitration Court of the Central District of 20 April 2017 on Case No. A09-2657/2016, a tax authority succeeded in proving that the provision of funds in the form of loans by a shareholder had an investment nature. The arguments presented by the tax authority were that the loan maturity, the interest rate and the loan amount had been regularly increased and funds received had been used for construction purposes, but the borrower had losses, meaning that it had no sources to repay the loan.

Determination No. 303-KG17-1509 of the Supreme Court of 28 March 2017 on Case No. A16-343/2016 concerned a situation in which a number of interest-free foreign currency loans had been issued to the taxpayer by a parent company. The funds had been used for construction purposes, the loan maturity had been extended on multiple occasions, the taxpayer had not paid off loans and the lender had not issued repayment demands. Arguing that the arrangement effectively constituted investment in the taxpayer's capital, the tax authority challenged the deduction of foreign exchange losses on the loans in question and reduced the company's accumulated losses.

CHALLENGES OF INTEREST RESULTING FROM DEBT-PUSH-DOWN TRANSACTIONS

The tax authorities show considerable interest in cases where funds are provided for a planned restructuring. In Ruling No. F09-2776/17 of the Arbitration Court of the Urals District of 16 June 2017 on Case No. A50-17405/2016[2], for example, it was found that loan repayment obligations had effectively been transferred to the very company for the acquisition of shares in which the loan had been obtained in the first place by means of merger of the acquiring company into the acquired one. Taking the tax authority's side in this case, the court asserted that the conditions laid down in Article 252 of the Tax Code for the tax-deductibility of interest had not been met, observing that the cost of purchasing shares in the company should have been incurred by the participants of the company, and not the company itself. The court concluded that the transfer of the debt obligations to the company had given rise to an unjustified tax benefit.

In Decision No. A11-6203/2016 of the Arbitration Court of the Vladimir Province of 13 February 2017, a tax authority challenged deduction of interest incurred on credit notes issued by way of payment for equity interests in another company that was later acquired by the taxpayer, contending that the acquisition of the equity interests had no business purpose. Taking the tax authority's side, the court asserted that the chosen approach to the merger of the companies had been contrived to enable the receipt of an unjustified tax benefit in the form of the reduction of taxable profit.

REQUALIFICATION OF SHARE DEAL INTO ASSET DEAL

Quite a few rulings concern cases in which the utilisation of tax benefits stipulated by the tax law was interpreted as the abuse of rights by the tax authorities. For instance, the Tax Code exempts the sale of equity interests from VAT. At the same time, a contribution to capital is not subject to VAT[3], while the sale of immovable property is subject to VAT. If a tax authority succeeds in proving that an unjustified tax benefit was obtained through a chain of transactions involving the contribution of immovable property to a company's capital and the subsequent sale of equity interests in that company to third parties, thus requalifying the transactions as the sale of immovable property, the taxpayer will be obliged to calculate VAT on the market value of the property sold[4].

WHAT TO DO

It may be recommended for real estate market players that they should precisely review their ownership and financial structures to identify areas that could be challenged by the tax authorities. Upon such review, we recommend investigating economic grounds for those transactions which are considered to be vulnerable to the tax authorities' challenges and prepare a defence file.

[2] It should be pointed out that the trial court sided with the taxpayer in this case.

[3] Subsection 1 of clause 1 of Article 146 of the Tax Code.

[4] For example, Ruling No. F01-1067/2017 of the Arbitration Court of the Volga-Vyatka District of 16 May 2017 on Case No. A39-1826/2016, Determination No. 309-KG17-53 of the Supreme Court of 10 April 2017 on Case No. A50-2818/2016, Determination No. 305-KG15-13840 of the Supreme Court of 3 November 2015 on Case No. A40-209850/14.

Hot Topic:

Lease termination: is the courts' approach likely to change?

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Russia's sharp economic downturn has made changing or cancelling long-term leases, especially those setting the rent in foreign currency, an urgent issue for many companies.

This issue becomes particularly acute when talks with landlords come to nothing because they are reluctant to revise foreign currency rents, claiming to have other foreign currency liabilities (such as bank loans for building the leased property) or are just disinclined to compromise.

Such reluctance on the part of the landlord usually means the tenant has to go to court to get the lease amended or cancelled.

Since the beginning of the currency crisis in 2014, several different judicial approaches have emerged when tenants try to get their leases changed or cancelled. The courts had already developed some of these during the many previous such crises.

For instance, claimants have sometimes referred to force majeure (Russian Civil Code art. 401) or a material change in circumstances (Russian Civil Code art. 451).

Since art. 451 of the Russian Civil Code had already been rejected by the Russian Supreme Commercial Court[1] as grounds for amending or cancelling an agreement, Vimpel-communications PJSC vs Tizpribor PJSC was a landmark case: the first instance court acknowledged that the sharp devaluation of the rouble was sufficient grounds for amending agreements setting prices in foreign currency[2].

This case might have set a precedent for future lease cases, but the decision of the Moscow Commercial Court was later reversed by a higher court and the parties subsequently reached an amicable settlement.

The prevailing current trend is still not to accept economic crises as a material change in circumstances[3].

Nor have courts ever included exchange rate changes in force majeure, and justifiably so, since the latter usually relates to emergencies and Acts of God (such as government actions and natural disasters).

Since whether a given circumstance is unforeseeable or extraordinary is a matter of fact, it is pointless to expand the force majeure clauses of a lease. Even if a court were

[1] Resolution of the Praesidium of the SCC RF of 13.04.2010 on case No. A40-90259/08-28-767.
[2] Decision of the Moscow Commercial Court of 01.02.2016 on case No. A40-83845/2015.
[3] Ruling of the RF Supreme Court of 07.03.2017 No. 305-ЭС17-713; Ruling of the RF Supreme Court of 15.08.2016 No. 305-ЭС16-10566.

to recognise an exchange rate change as force majeure[5], this would merely put off performance of the obligation to pay the rent, without allowing for change or cancellation of the lease itself.

Another, relatively new, argument for amending or cancelling a lease is that the landlord is the stronger party to the agreement. There are different variations on this theme: to have the payment in foreign currency recognised as an unfair contractual condition (Russian Civil Code art. 428) or abuse of rights (Russian Civil Code art. 10), or have the lease invalidated on special grounds (such as it being oppressive, etc.).

To rely on art. 428 of the Russian Civil Code for having an agreement amended or cancelled, the tenant needs to prove that the relevant condition meets the following criteria: the wording was proposed by the landlord, the tenant was not in a position to argue, the condition is clearly unreasonable and materially unbalances the parties' interests[4]. It is usually not too difficult to prove the first three criteria, since the landlord is most often a professional on the property lease market (such as a retail and entertainment centre owner that uses basically the same lease template with tenants of separate premises). To classify proposed adhesion contract terms as coercive, the court assesses both the parties' negotiating strengths and other factors, such as competition on the market, whether the adhering party can in reality negotiate or conclude a similar contract with another party under different conditions, etc.

Yet this practice is not widespread and there are but a few court judgements amending or cancelling a lease[5]. Why? Because the last criterion, imbalance of the parties' interests, is the most difficult to prove under the conditions prevalent in the Russian economy today, when a currency clause is a way to insure (hedge) against the risk of inflation. This risk is particularly great if the lease is concluded for a long period. If the currency strengthens, the debtor naturally gains from a monetary liability under a currency clause, which then appears unfair from the creditor's (landlord's) point of view. This is how the courts traditionally argue when dismissing a tenant's claim for termination or amendment of a lease[6].

So where do we stand now? No: currently the courts do not provide a universal way to escape long-term obligations. This can be regarded as a sort of judicial contribution to economic stability.

Another way of insuring exchange risks is to conclude a lease setting exchange rate corridors (exchange rate changes are introduced within certain bounds as a condition for calculating a payment) or entitling the parties to withdraw unilaterally from the agreement if the exchange rate changes sharply. If a lease lacks such conditions, an attempt could be made to cancel it on other grounds. For example, by having an expert review conducted of the condition of the leased premises in order to refer subsequently to violation by the landlord of its obligations. Such an expert review often throws up a multitude of defects. It is riskier just to vacate the leased premises and sign a unilateral statement of delivery and acceptance, providing the landlord with a list of candidates interested in concluding a lease.

[4] Resolution of the RF Supreme Court Plenum No. 16 of 14 March 2014 "On Freedom of a Contract and Its Limits".
[5] Resolution of the Commercial Court for the Volga Circuit of 27.10.2014 on case No. A12-1193/2014.
[6] Resolution of the Commercial Court for the Moscow Circuit of 13.05.2016 on case No. A41-71971/2015.

Hot Topic:

Current trends on the housing market

Lilia Ganagina
Marketing & Communications Director, YIT

It has recently become apparent how customers' requests and the product have changed due to the economic situation. The rouble weakness led to boom in demand for real estate – everybody was trying to make a good investment and secure their savings.

However, growth in demand was accompanied by a weak rouble combined with decrease in purchasing power. As a result, apartments with extremely small total area appeared on the market. At first, the apartments' size decreased as an answer to the demand from private investors, who leased them out or resold. Of course, the most liquid commodity is the cheapest one. According to analysts, in the last 7 years the total square footage of an average apartment in new buildings has decreased by 23% – from about 80 sq m to 60 sq m. But these are average numbers, meanwhile apartments with 16-20 sq m in total area are becoming common on the market. But some developers have exceeded even these numbers: according to RBC, in Novosibirsk it was possible to find an apartment with the size of 8 sq m!

Now, when private investors have disappeared from the market as a class and there is no improvement in purchasing power, such small apartments become just the most affordable product on the market for the majority of customers. Of course, it is difficult to qualify such housing accommodations as comfortable. It may seem to be cozy in one room, but in reality, it turns out to be a 'pencil box' that is difficult to outfit, and worst of all, it is usually supposed to be a home not for a student, but for a whole family with small kids. So, the apartment that was good for a rental, becomes unsuitable for a final customer. Developers reacted fast and the total areas have started to grow. But the problem with financing is still up-to-date, the average customer is not ready to pay for extra space. Where is the answer to that?

We suppose that first of all it is essential to work with the functionality of the apartment, to find the balance between the clients' needs and their budgets. It means enlarging the total square footage just a little so all the main 'working' zones stay in place: kitchen, living room and bedroom. The 'studio' layout could be a solution, this popular European option is even called a Euro layout in Russia. By combining rooms, we could economise the total square footage and add such a bonus as a dressing room. Some of our complexes became a testing area for a new layout developed by Finnish architects, where the bedroom, dressing room (and zone for washer and dryer if there is a lot of space) and bathroom compose a line. At the same time, the hallway, kitchen and living room are a common area from which you can also enter the bathroom. This layout lets us create a master part of the apartment that is a private and common area. At the same time, the total square footage of such an apartment is still small, about 40 sq m on average. As for Finland, YIT professionals developed a new concept of apartments. This product is intended first of all as a solution that allows following of its master's needs, reshaping and changing according to different life situations, such as changes in family size or growing of its members. There are no dividing walls in this type of apartments, so space is divided by partition walls or even furniture, and thus the residents have more storage space. They can add or remove any items if necessary. Walls are covered with decorative panels to help create the unique style and to renovate the apartment without major repairs. The customers can choose between some alternative interior styles to make the apartment personalised.

In Russia, we are also creating new architectural concepts and try to localise the best European experience. Our current target is to provide as many types of layouts as possible and to enrich each project by some unusual solutions, for example, terraces or 'places of interest' inside of the complex.

It is interesting that not only the Russian market is subject to changes as time goes by or under economic conditions pressure – other countries are no exception. For example, Finns are giving up such a traditional part of the apartment as a sauna. More and more customers are voting for common saunas placed inside the residential complex to save space inside their own apartment. Balconies are one more trend. Lately, these spaces have been used more and more widely: people are cooking there or growing flowers or vegetables and of course, just spending spare time.

It is the market trends that developers must follow. We think that it is a real talent to catch it and be in time with the appropriate product, this is 90% of success. That is why we always stress that the client is our starting point, that the times when the product was in first place and the customers' interests followed are long gone.

Association of European Businesses

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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.

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