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REAL ESTATE MONITOR

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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,

Currently, the real estate market is in stagnation and, according to experts, the situation will remain as such for several years. Although real estate prices have not changed as a result of the crisis, we should keep in mind that the rouble has depreciated sharply, interest rates have rocketed and mortgage are out of the of many people. Compounding that is the lack of income growth and growing unemployment; and, as people are afraid of losing their jobs, they are more focused on making ends meet than housing.

The real estate market is still open to those who have savings and who are willing to invest in something sustainable. Many after selling real estate property buy something new at once, even cheaper than the previous one.

It is my hope that you will find this publication a useful resource, and that it will open new horizons for your business. I look forward to seeing many of you at our upcoming Real Estate Committee events.

I would like to take this opportunity to thank our Real Estate Committee members who have actively contributed to this publication and the other activities of the Committee.

On this note, I wish each and every one of you a Merry Christmas and a prosperous New Year!

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

Dear readers,

In a few weeks we are going to celebrate Christmas and the coming New Year, so it is the perfect time to draw some preliminary conclusions.

2015 was very eventful for the real estate industry. So far the downturn in the industry has not made way for clear visible growth but nonetheless we are seeing that the strong base of the previous years is giving the market a push.

Prime real estate assets are being traded by market leaders while consolidated real estate players are staying on the market and taking the share of smaller companies that leave the ground. We are seeing new developers with previous experience in the industry stepping into residential projects.

Residential projects in the meantime are gaining popularity among investors and developers as we register a switch to a bigger residential component in the multifunctional projects that have been announced.

Transactions in logistics are going exceptionally well considering their current volume. 2015 is setting a record high in this industry. However, at the end of the year we will need to look at net absorption as the main indicator.

We are seeing that food retailers are growing and expanding their capacity, taking over smaller players and their market share. This also provides work for land owners, developers and the construction industry.

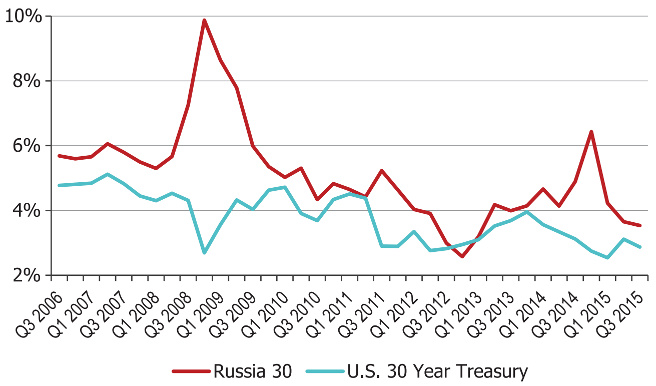
The Real Estate Committee wishes you a Merry Christmas and a Happy New Year and is looking forward to seeing you at our meetings and events!

Moscow market overview

Capital market

• Inflationary expectations remain elevated and debt financing is still very expensive. However, during Q3 2015, we have seen increasing evidence that the economy is starting to stabilise. This is having a positive impact on the real estate market with rents starting to show evidence of bottoming out. Investment volumes remain subdued, however, further currency and macro stability will bring momentum going into 2016. (1 ▶)

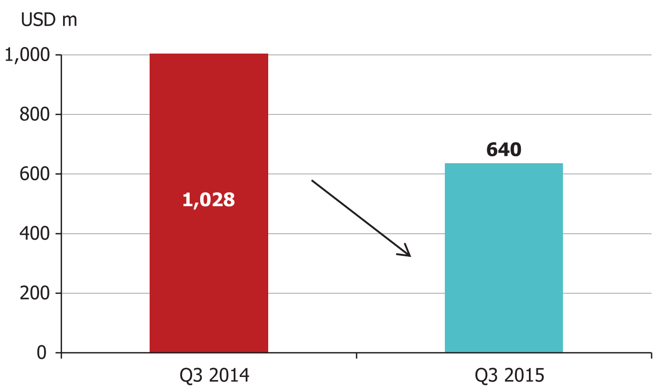
1 ▶ BORROWING COSTS



Source: JLL

• In Q1–Q3 2015, Russian real estate investment volumes decreased by 38% compared to the same period of the previous year, with total investment volumes at USD 1.7 bn. This includes the Q3 investment volume of USD 640 mln, down 38% YoY but up 11% QoQ. (2 ▶)

2 ▶ INVESTMENT VOLUMES



Source: JLL

• We do not see enough evidence to upgrade our investment volume forecast for this year from USD 3.0 bn, indeed we continue to see downside risks in the short term.

• In Q3 2015, Moscow prime yields remained at 10.5% and 10.75% for offices and shopping centres respectively, and at 12% for warehouses. We think the demand cycle is now passing through the trough suggesting that rates may start to fall through Q4 2015 across all sectors.

• In Q1–Q3 2015, investor interest was focused on the office segment with 38% of the total investment volume due to the sale of Metropolis BC. Moreover, the share of the retail sector reached 34% due to the sale of Modny Sezon.

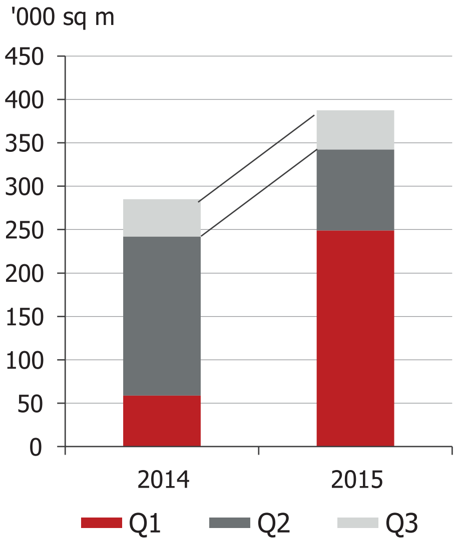
• Investors continued to focus on assets located in Moscow. These accounted for 99% of total investments in Q3 2015. Investments in St. Petersburg reached USD 8.2 mln in Q3 2015 compared to USD 88.5 mln last year, pulling its share down to 1% from 17% for the same period last year.

• The share of foreign capital in Russian investment transactions was 47% for Q1–Q3 2015, up from 31% for the same period of 2014.

Retail market

• In Q3 2015, only RIO on Kievskoye Highway with 45,300 sq m* was delivered in Moscow. As a result, the volume of new retail space for first nine months of 2015 was 387,500 sq m. (3 ▶)

3 ▶ COMPLETIONS

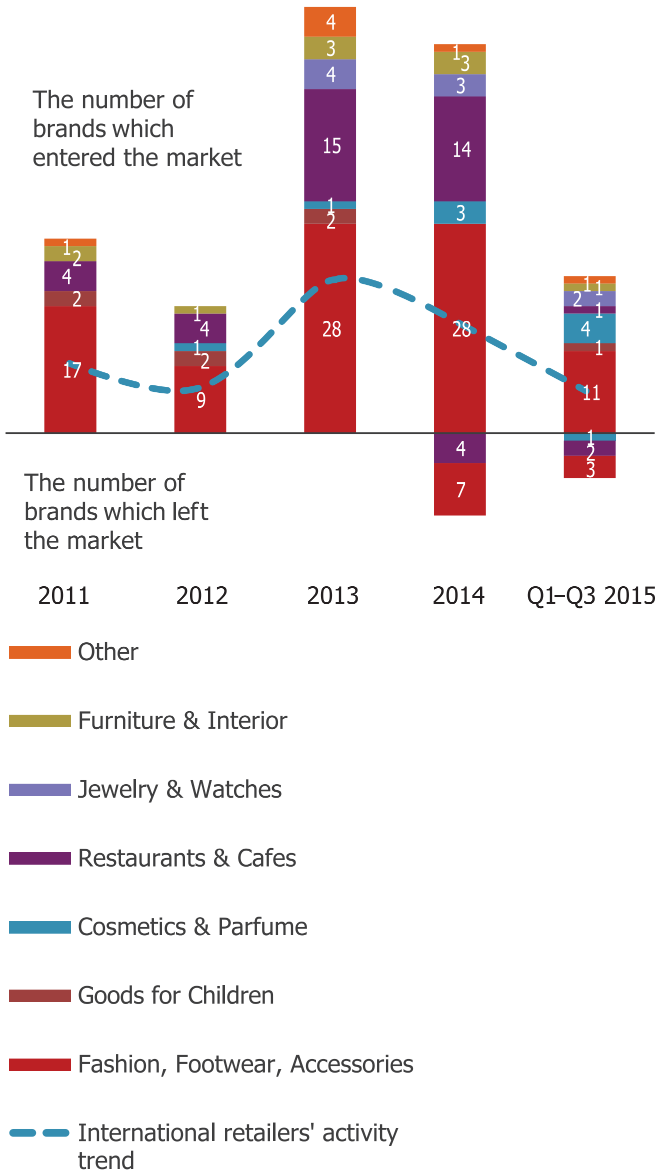


Source: JLL

• The volume of new retail for first nine months is now 36% higher than the same period last year. Therefore, we expect Q4 2015 to be weak. For the full year we anticipate a 25% fall in overall volumes versus 2014 with 450,000 sq m coming to the market.

• The overall vacancy rate remained at the Q2 2015 level of 7.5%. Nevertheless, in core successful shopping centres it actually decreased from 1.3% to 1.0%. This confirms a trend we have seen since the beginning of the year; retailers are looking for premises in the most attractive and historically successful projects – despite the high rents – at the expense of shopping centres that have opened more recently. Retailers that are already well established in the market as well as international newcomers are giving preference to shopping malls with a strong track record. Nonetheless, over the past 12 months the vacancy rate has been gradually decreasing in the majority of newly opened shopping centres. Despite the comparatively low footfall which is typical for new schemes, such projects try to attract tenants via favorable lease terms and stand-out concepts. (4 ▶)

4 ▶ MARKET PARTICIPATION



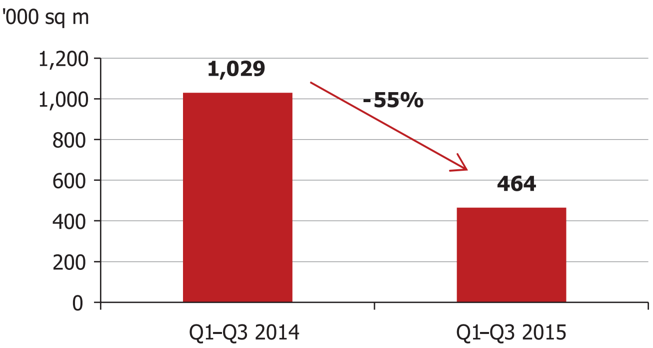
Source: JLL

* Prime and average rents in shopping centres are stable and at the same level of Q2.

Office market

• Deliveries of new office space in Q3 2015 amounted to 241,000 sq m, which is half the space that entered the market over the same period last year. Class A premises comprised a 54% share of total deliveries over Q3. The total amount of new space for the first nine months was 464,500 sq m, which is about a 55% YoY drop. (5 ▶)

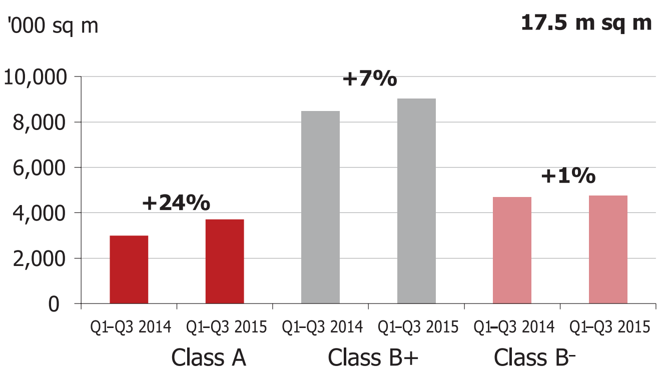
5 ▶ REAL ESTATE SUPPLY



Source: JLL

• By the end of the year, another 366,000 sq m of office space is expected to enter the market, bringing the total amount of new deliveries for 2015 to 830,000 sq m, which is 41% less YoY. In the longer term, the future supply of offices will be much tighter compared to previous years due to the end of the ongoing construction cycle. (6 ▶)

6 ▶ REAL ESTATE SUPPLY BY SECTOR



Source: JLL

• The volume of office take-up over the past three months was 305,000 sq m, which is an increase of 10% QoQ (though flat YoY). For the first nine months the amount of space being taken from the market was about 800,000 sq m, which is about a 3% drop compared to the same period last year.

• The total vacancy remained unchanged over the quarter at 17%. At the end of Q3, the vacancy rate in Class A premises was 26.8% (compared to 27.4% in Q2).

• The rental asking prices for premium offices were in the range of USD 750–840 sq m/year, while for Class A rental asking prices were close to the levels seen in Q2 – USD 450–650 sq m/year for Class A and USD 275–450 sq m/year for Class B+ office premises. (7 ▶)

7 ▶ RENTS BY SECTOR

Prime*	Class A	Class B+	Class B-
750–840	450–650	275–450	175–250

* Rents in high quality buildings in the Central Business District (CBD).

Source: JLL

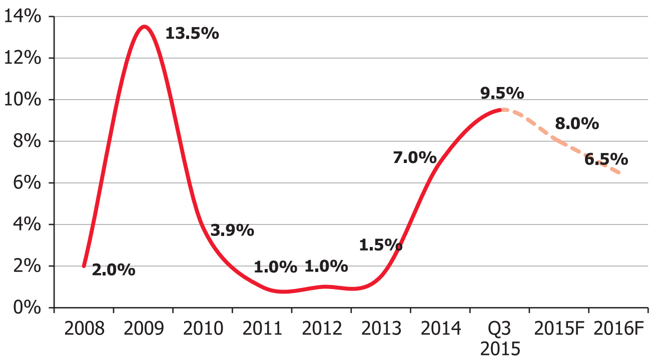
Warehouse market

TRENDS

We forecast that the vacancy rate will decrease by the end of 2015. Most likely there will be a lack of speculative warehouse space in the Moscow region in the beginning of 2016. This will bring more activity into the built-to-suit segment.

In 2016, the volume of new construction will depend on demand. Rental rates during 2016 will remain stable. (8 ▶)

8 ▶ VACANCY RATE, THE MOSCOW REGION, CLASS A



Source: Cushman and Wakefield

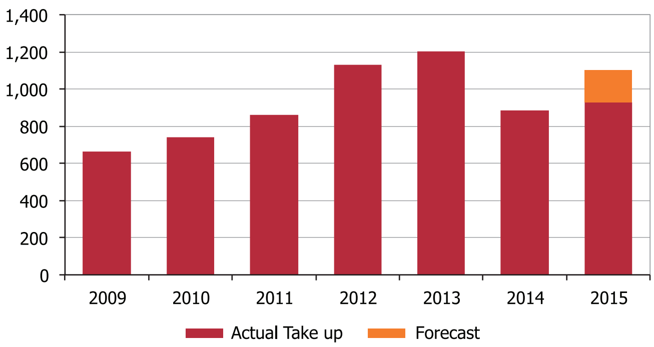
DEMAND

The total take up in Q3 2015 reached 520,000 sq m, which is 2.3 times higher than the average for 2008–2014. The decrease in the volume of new construction and the stabilisation of rental prices at the lowest level since 2007 have led large retail chains to developing their logistics network.

We forecast that the total volume of transactions in 2015 will be around 1.1 mln sq m which is 25–30% higher than in 2014.

In 2016, the take up will be lower than in 2015 due to the slow growth of the Russian economy and the lack of pent-up demand for warehouse projects. (9 ▶)

9 ▶ TAKE UP, CLASS A



Source: Cushman and Wakefield

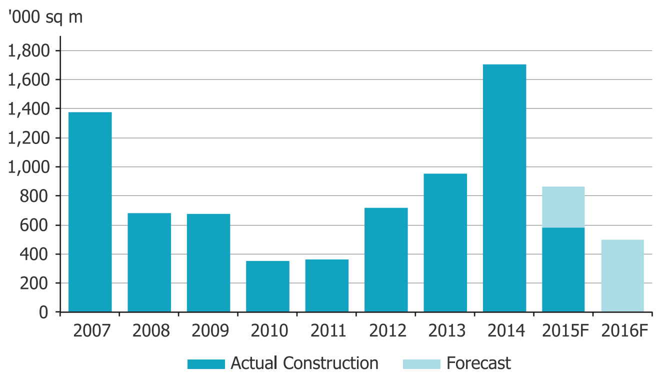
NEW CONSTRUCTION

75,000 sq m of quality warehouse space was delivered to the market in Q3 2015. The vacancy rate has not changed and remains at 9.5%. Developers are finishing the construction projects started last year, and no new projects have been announced. The delivery of some projects has been postponed. We expect around 800,000 sq m of quality warehouse space to be delivered to the market in 2015.

Developers rarely deal with speculative construction. The majority of new projects in 2016 will be realised according to client contracts signed in 2014–2015.

400,000–500,000 sq m of quality warehouse space will be delivered to the market in 2016 according to our forecast. (10 ▶)

10 ▶ NEW CONSTRUCTION, CLASS A AND B



Source: Cushman and Wakefield

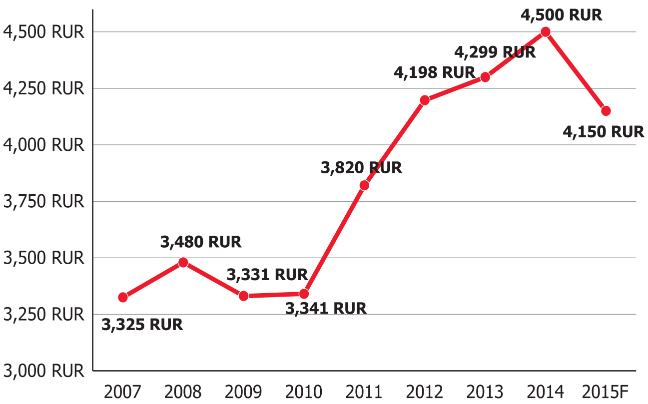
RENTAL RATES

All the vacant warehouse space in the Moscow region is offered for rent in roubles. In Q3 2015, the rental rate reached 3,800–4,500 roubles per sq m per year, excluding operational expenses, utility costs and VAT.

Operational expenses are 1,000–1,300 roubles per sq m per year depending on the project.

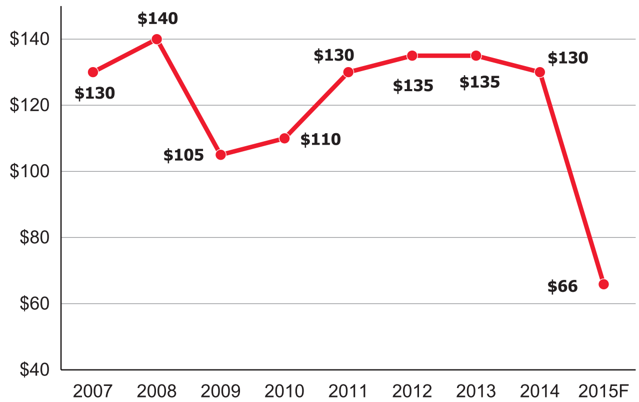
We expect a slight rental rate increase in Q4 2015. (**11, 12**▶)

11 ▶ NET RENTAL RATE IN ROUBLES



Source: Cushman and Wakefield

12 ▶ NET RENTAL RATE IN US DOLLARS



Source: Cushman and Wakefield

REGIONS

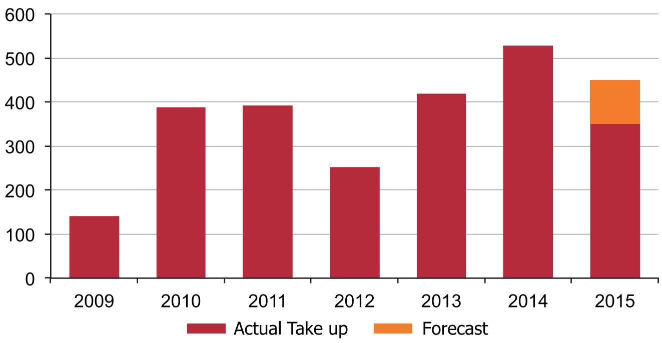
122,000 sq m of quality warehouse space was delivered to the market in the regions in Q3 2015. Half of it was delivered in Rostov-on-Don (33,000 sq m) and Samara (29,000 sq m). We expect 800,000 sq m of quality warehouse space to be delivered to the market in the regions in 2015.

The total take up volume in Q3 2015 reached 170,000 sq m, which is higher than the average in 2008–2014.

Rental rates in Q3 2015 slightly decreased in class A warehousing to 3,500–4,000 roubles per sq m per year, excluding operational expenses, utility costs and VAT.

We forecast that the take up will be 450,000 sq m in the regions in 2015. (**13** ▶)

13 ▶ TAKE UP ('000 SQ M)



Source: Cushman and Wakefield

Hospitality market – Moscow hotels in Q3 2015

The average occupancy rate across all market segments of Moscow hotels in Q3 2015 demonstrated a positive trend (71%) as compared to the same time period of 2014 (66%). The sharp currency fluctuations resulted in a 41% decrease in the US dollar nominated ADR (average daily rate) and a 37% decrease in the RevPAR (revenue per available room), which totaled USD 118 and USD 82 respectively. The ADR nominated in roubles decreased by 3% (RUR 6,971), while the RevPAR was up by 3% and amounted to 4,831 roubles, as compared to January–September 2014.

The upscale segment indicators were up in roubles compared to Q3 2014, while the US dollar ADR (average daily rate) and RevPAR fell dramatically. The US dollar ADR dropped by 39% (USD 186), the US dollar RevPAR fell by 33% (USD 125). The ADR nominated in roubles increased by 2% (RUR 11,029), and the rouble RevPAR by 10% (RUR 7,418). The overall occupancy rate increased by 5% (67%).

Business hotels demonstrated the following results in January–September 2015. The US dollar RevPAR decreased by 40% (USD 66), which was composed of a 5% occupancy increase (70%) and a 44% drop in the ADR nominated in US dollars (USD 94). The rouble RevPAR remained almost unchanged and amounted to RUR 3,902 while the ADR dropped by 7% (RUR 5,576).

A certain decrease of the ADR and RevPAR was observed in the midscale segment, while the overall occupancy rate grew by 2% (74%). The ADR amounted to USD 73 as a result of a 44% decrease, while the RevPAR nominated in US dollars dropped by 43% to USD 54. The rouble ADR and RevPAR decreased by 8% and 6% respectively (RUR 4,307 and RUR 3,172).

As mentioned above, the continuous extreme fluctuations of the US dollar against the rouble have had a significant impact on further declines in the dollar equivalent. As the US dollar went up against the rouble by 59% in January–September 2015, the dollar figures showed a much stronger decline than the rouble ones.

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

• The variation between the upscale and midscale segments comprised USD 71/RUR 4,246 compared to USD 94/RUR 3,358 in the same time period of 2014.

• The difference in the RevPAR between upscale and business hotels changed to USD 59/RUR 3,516 compared to the Q3 2014 results (USD 79/RUR 2,823). (**14 ▶**)

14 ▶ HOTELS OPENED IN JANUARY–SEPTEMBER 2015 IN MOSCOW AND THE MOSCOW REGION

Name	Room number	Address	Class
Moscow			
Marriott Novy Arbat	234	32, Novy Arbat street	5 stars
Holiday Inn Seligerskaya (rebranded – formerly Iris Congress Hotel)	201	10, Korovinskoe Highway	3 stars
Ibis Moscow Dynamo	317	37/8, Leningradskoe Highway	3 stars
Garden Embassy	63	5, Botanichesky Lane	ND
Gorod	27	Kazansky railway station	2 stars
Total: 5 hotels	**842**		
Moscow Region			
Amaks Krasnaya Pakhra	264	Bld. 1, 10, Parkovaya Street, Krasnoe village	3 stars
Atelika Sosnovy Bor Country Hotel	91	Saburovo village (32 km from MKAD, Schelkovskoe highway)	2 stars
Atelika Lipki Country Hotel	175	Lipki village (35 km from MKAD, Mozhaiskoe highway)	2 stars
Total: 3 hotels	**530**		

Source: EY database, open sources, operators' data

HOTELS OPENED IN Q1 2015:

• Marriott International announced the opening of Moscow Marriott Hotel Novy Arbat on 32, Novy Arbat Street, Moscow, in February 2015. The hotel offers 234 rooms, a lobby-bar, a bar, a restaurant, four conference halls, a banquet hall, a fitness centre, a beauty and hairdresser salon and a laundry.

• Iris Congress Hotel has been managed by the InterContinental Hotels Group since June 2015. The new name of the hotel located at 10, Korovinskoe Highway, is Holiday Inn Moscow – Seligerskaya. The hotel offers 201 rooms, a restaurant, a lobby bar, a café, four conference halls, banquet and ball halls, a fitness centre with a swimming pool and a sauna.

• The country hotel Sosnovy Bor went under the management of the Atelika hotel chain in February 2015. The hotel located in Saburovo village (32 km from MKAD, Schelkovskoe highway), the Moscow region, offers 91 rooms and a cottage, conference halls, meeting rooms, banquet halls, a fitness and recreation zone with a swimming pool.

• The country hotel Lipki went under the management of the Atelika hotel chain in June 2015. The hotel located in Lipki village (35 km from MKAD, Mozhaiskoe highway), Moscow region, offers 175 rooms, a restaurant, two bars, fitness and SPA centres with a swimming pool, a sports ground, a billiard room, a library and a children's club.

HOTELS OPENED IN Q2 2015:

• Garden Embassy Hotel opened in the Botanic Gardens of MSU on 5, Botanichesky Lane, Moscow, April 2015. The hotel offers 63 rooms, a restaurant, office space, a sports centre, a beauty salon, a car-wash and underground parking.

HOTELS OPENED IN Q3 2015:

• Hotel Ibis Moscow Dynamo managed by Accor Hotels opened in Moscow, July 2015. The hotel located on 37/8, Leningradsky Avenue, offers 317 rooms, a restaurant, a bar, and five conference halls.

• The mini-hotel Gorod opened in Moscow at Kazansky railway station in July 2015. The hotel offers 27 rooms, a game room and a library.

• Krasnaya Pakhra Resort managed by Amaks Hotels & Resorts opened in the Moscow region, July 2015.

The hotel located in bld. 1, 10, Parkovaya Street, Krasnopakhorskoe, Krasnoe Village, offers 264 rooms, a restaurant, a lobby and phyto bars, a conference hall, a concert hall, a recreational complex with two swimming pools, an open-air sports ground, a pharmaceutical garden and a children's playground.

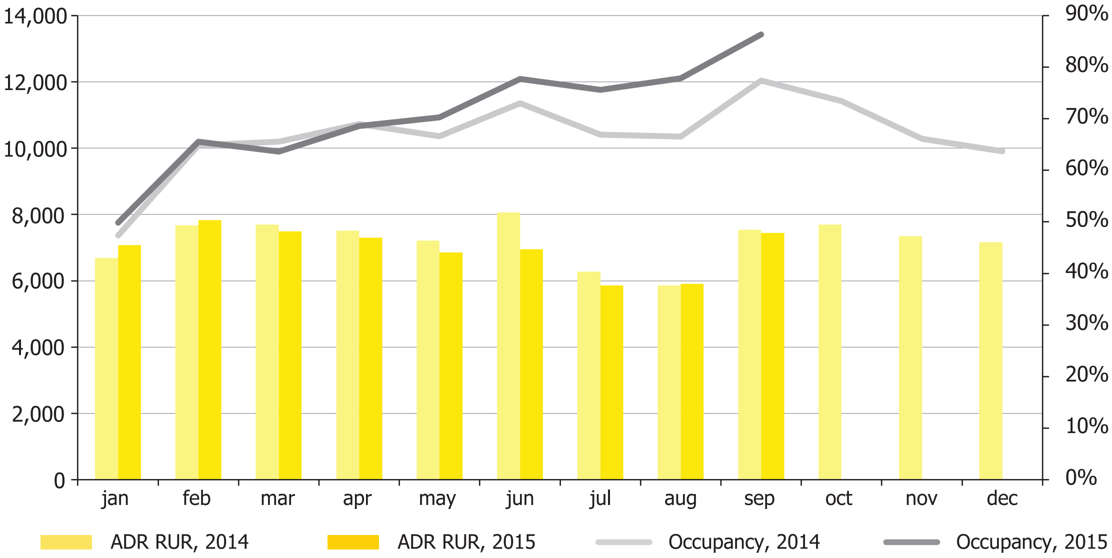
We expect the following hotels to open by the end of 2015: (**15, 16, 17, 18, 19, 20 ▶**)

15 ▶ FUTURE HOTELS ANNOUNCED FOR OPENING IN MOSCOW AND THE MOSCOW REGION IN 2015

Name	Room number	Address	Class
Moscow			
Hampton by Hilton Moscow Strogino	214	Bld. 1A, 20, Kulakova street	3 stars
Palmira Business Club	228	6, Novodanilovskaya embankment	4 stars
Moscow Region			
Ibis Stupino	120	Stupino, Pobedy Avenue	3 stars

Source: EY database, open sources, operators' data

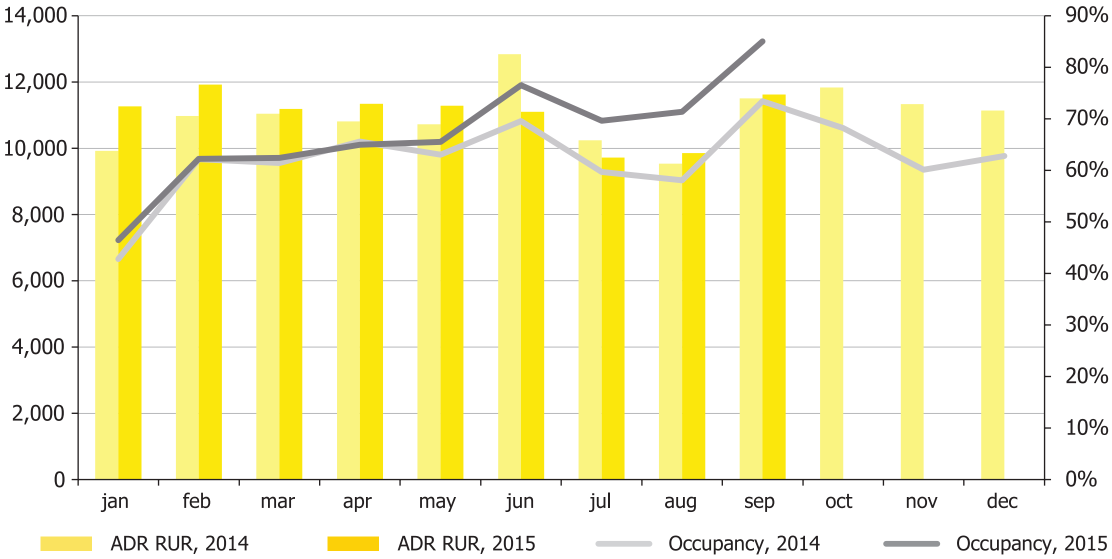
16 ▶ AVERAGE MARKET ADR* (RUR) AND OCCUPANCY RATES, 2015 VS. 2014



* Average daily rate

Source: EY analysis

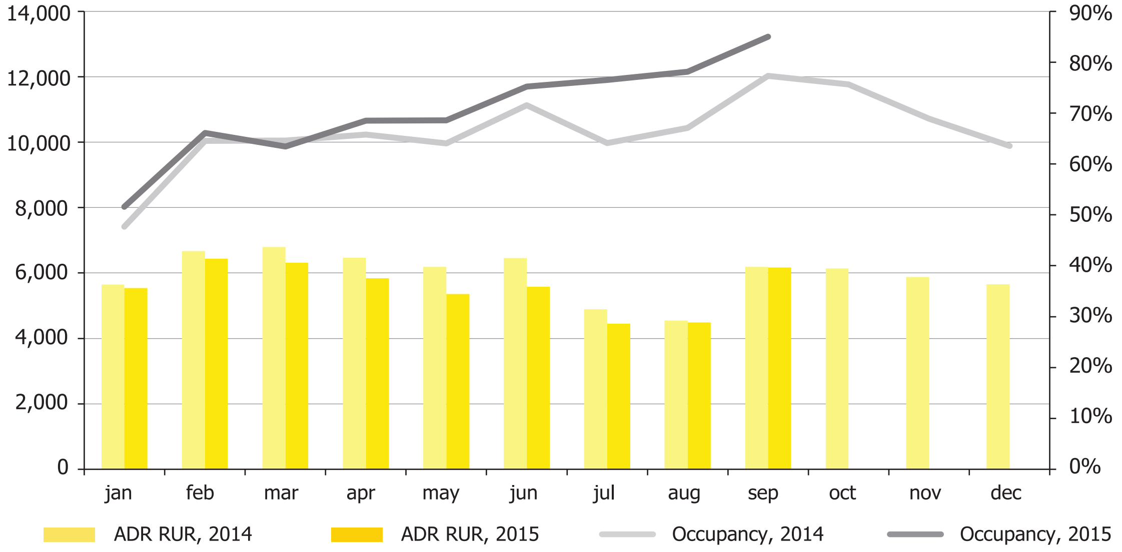
17 ▶ 5-STAR HOTELS: ADR* (RUR) AND OCCUPANCY RATES, 2015 VS. 2014



* Average daily rate

Source: EY analysis

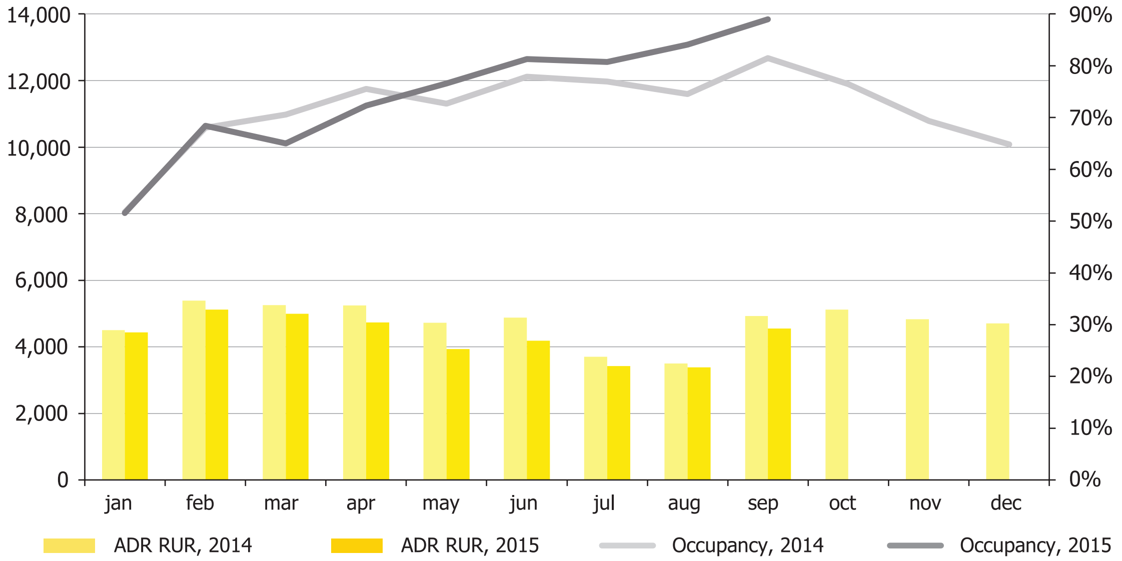
18 ▶ 4-STAR HOTELS: ADR* (RUR) AND OCCUPANCY RATES, 2015 VS. 2014



* Average daily rate

Source: EY analysis

19 ▶ 3-STAR HOTELS: ADR* (RUR) AND OCCUPANCY RATES, 2015 VS. 2014



* Average daily rate

Source: EY analysis

20 ▶ OPERATIONAL INDICES DYNAMICS

	January–September 2015 USD/RUR	January–September 2014 USD/RUR	January–September 2015 vs. January–September 2014, %, USD/RUR	2014
5 stars				
Occupancy	67%	62%	5%	62%
Average daily rate (ADR)	USD 186/RUR 11,029	USD 303/RUR 10,841	-39%/2%	USD 285/RUR 10,989
Revenue per available room (RevPAR)	USD 125/RUR 7,418	USD 188/RUR 6,734	-33%/10%	USD 178/RUR 6,871
4 stars				
Occupancy	70%	65%	5%	66%
ADR	USD 94/RUR 5,576	USD 167/RUR 5,985	-44%/-7%	USD 156/RUR 5,961
RevPAR	USD 66/RUR 3,902	USD 109/RUR 3,911	-40%/0%	USD 103/RUR 3,957
3 stars				
Occupancy	74%	72%	2%	72%
ADR	USD 73/RUR 4,307	USD 131/RUR 4,680	-44%/-8%	USD 123/RUR 4,731
RevPAR	USD 54/RUR 3,172	USD 94/RUR 3,376	-43%/-6%	USD 88/RUR 3,391
Average				
Occupancy	71%	66%	4%	67%
ADR	USD 118/RUR 6,971	USD 201/RUR 7,168	-41%/-3%	USD 188/RUR 7,227
RevPAR	USD 82/RUR 4,831	USD 130/RUR 4,674	-37%/3%	USD 123/RUR 4,740

Source: Smith Travel Research, EY analysis

Moscow housing market

Without any doubt, at the end of September 2015 it is possible to say that the current economic situation has strengthened competition between landlords. Moreover, it has influenced their attitude to their business, forcing them to revise their rates. However, it should be noted that the situation has given rise to a large number of quality properties, which includes properties being put on the market for the first time. These changes have given tenants more freedom with regards to price and location. Overall, the increased choice has stimulated the market and encouraged stable demand throughout 2015.

DEMAND

At the end of September 2015, according to Intermark Relocation estimates, the total demand for high-budget rentals in Moscow decreased by almost 20% against the same period in 2014.

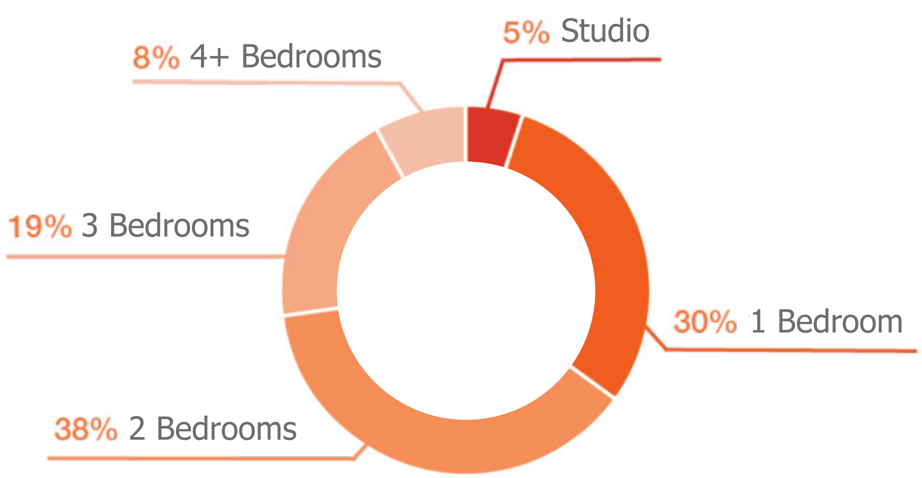
Nevertheless, Q3 2015 was more active than the previous quarters but uncertainty surrounding market prospects and the unstable exchange rate are still deterrents. On a positive note, the market hit its most difficult period between December and January, and the following months demonstrated a low but stable numbers of deals for high-budget rental properties through to September. By the end of September, Intermark analysts observed a slight increase in the number of deals in comparison to the summer period.

With 65% of all requests, foreign customers continue to dominate the demand for high-budget apartments. Compared to the previous year, their share has not changed, however their number has decreased.

Due to the correction of rental budgets, freedom of choice for potential tenants has increased significantly and experts point to the arrival of new properties on the market that are being rented out for the first time. The appearance of new property can be attributed to recent sales on the real estate market. Limited tenant and buyer demand during the current period means that landlords are often guided by the principle "what will be faster: selling or renting?" Therefore, it is possible to say that new properties of a higher quality and appropriate pricing are maintaining stable interest among tenants.

Two-bedroom apartments (38% of the requests) are the most in demand among tenants. However, the third quarter showed growing interest in one-bedroom apartments (30%). (21 ▶)

21 ▶ DEMAND ANALYSIS OF EXPAT HOUSING MARKET IN MOSCOW IN TERMS OF NUMBER OF ROOMS

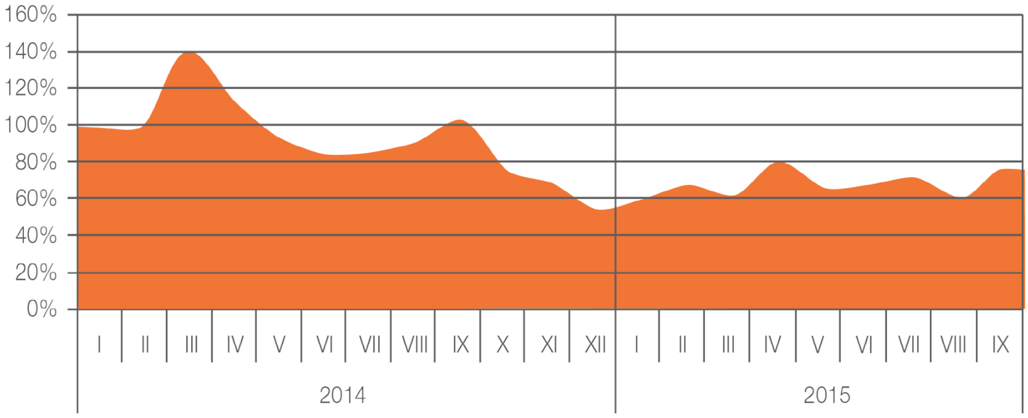


Source: Intermark Relocation

In September 2015, demand is at the same level as in April, but 20% lower than in September 2014. (22 ▶)

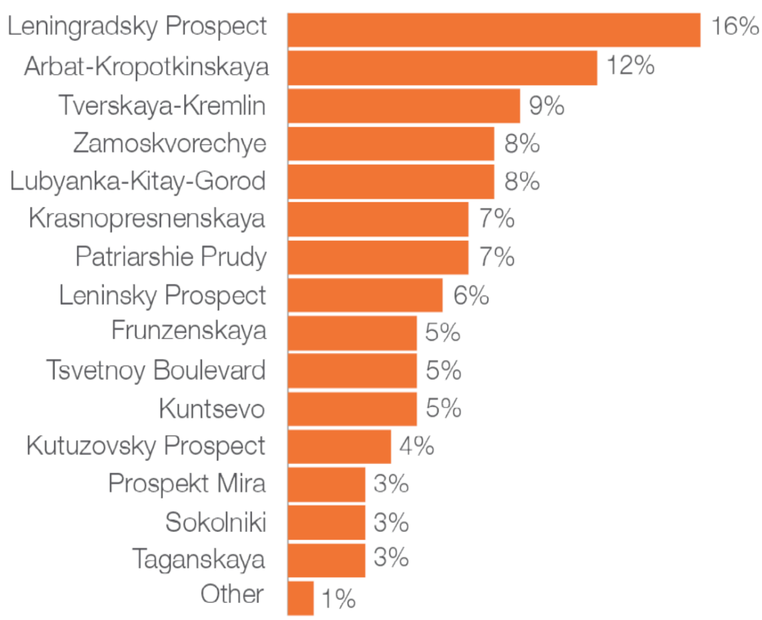
The top five locations in terms of demand remain the same as last year, but the leader has changed: Leningradsky Prospect (16% of demand) has replaced Arbat and Kropotkinskaya as the most attractive district in Moscow, up from 12% last year. Three areas attract more than a third of market demand: Leningradsky Prospect, Arbat-Kropotkinskaya and Tverskaya-Kremlin. (23 ▶)

22 ▶ DYNAMICS OF THE DEMAND OF MOSCOW'S PRIME RENTAL MARKET (JANUARY 2014 – 100%)



Source: Intermark Relocation

23 ▶ MOST POPULAR AREAS FOR LIVING IN MOSCOW (JANUARY–SEPTEMBER 2015)



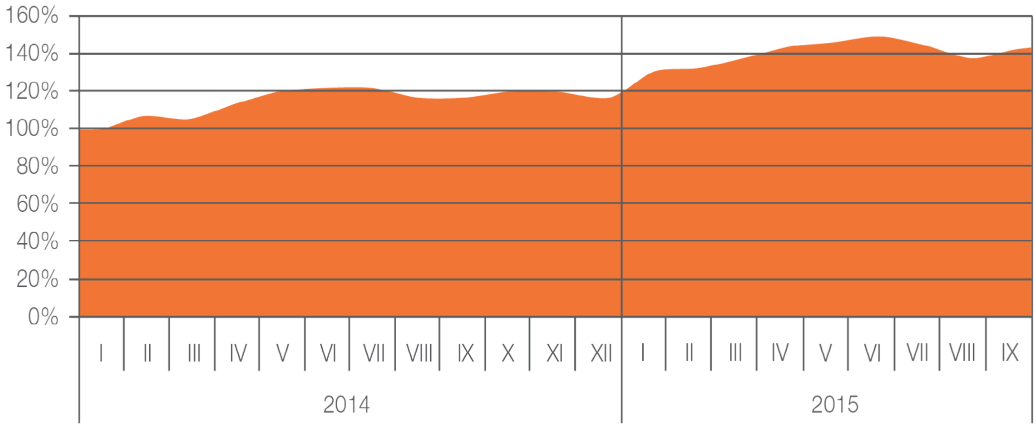
Source: Intermark Relocation

SUPPLY

Competition among landlords has increased significantly over the last year. The number of high-budget rental properties in Moscow grew 21% by the end of September 2015 against the same period last year, and 42% against the beginning of 2014.

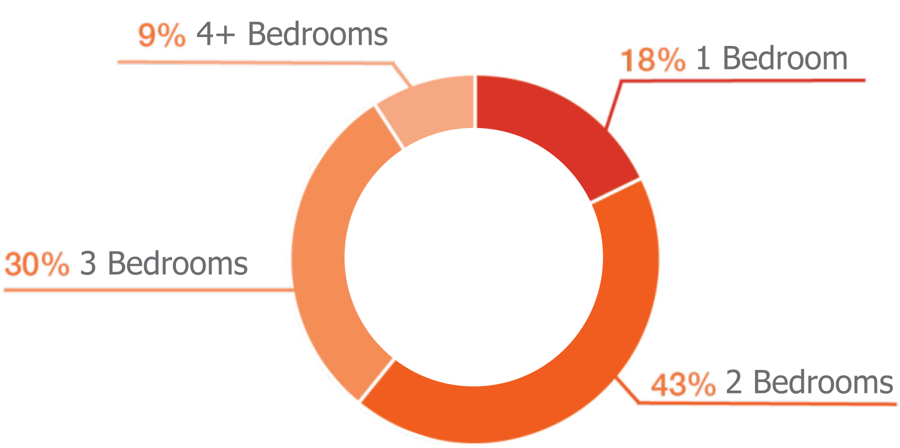
The growth in available properties was noticeably stronger at the beginning of this year: it gained 12% from December 2014 to January 2015 and another 6% in April. (24 ▶) 2- and 3-bedroom apartments compose 73% of the properties in the high-budget rental market. (25 ▶)

24 ▶ DYNAMICS OF THE SUPPLY OF MOSCOW'S PRIME RENTAL MARKET (JANUARY 2014 – 100%)



Source: Intermark Relocation

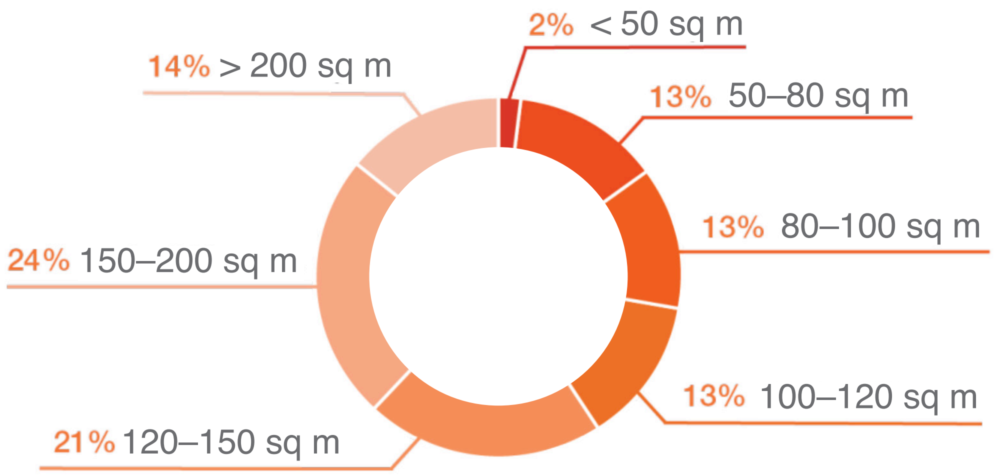
25 ▶ SUPPLY ANALYSIS OF EXPAT HOUSING IN MOSCOW IN TERMS OF NUMBER OF ROOMS



Source: Intermark Relocation

Like last year, there has been a shift towards more spacious properties. Apartments with an average area of 120–150 sq m and 150–200 sq m dominate the market with a share of 21% and 24% respectively. The surface area of properties is distributed quite evenly; however, the traditionally smaller apartments are harder to find. (26 ▶)

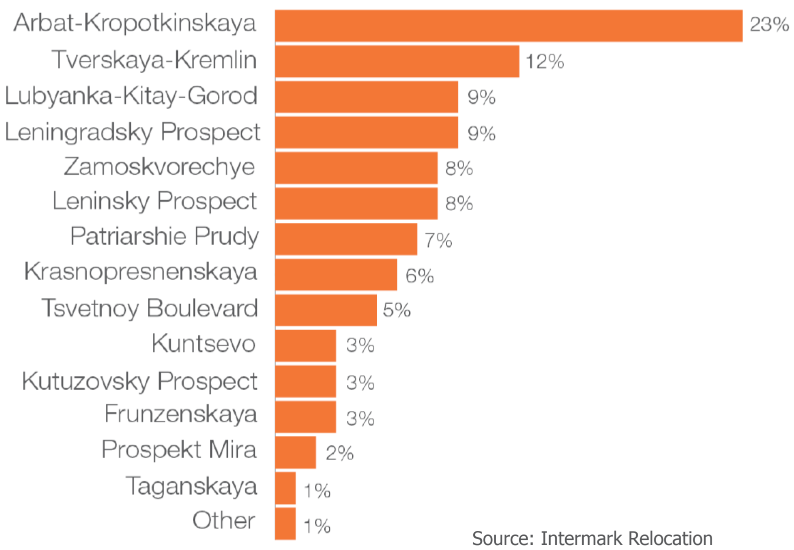
26 ▶ SUPPLY ANALYSIS OF EXPAT HOUSING MARKET IN MOSCOW IN TERMS OF AREA (SQ M)



Source: Intermark Relocation

The territorial structure of available properties in comparison with last year is almost unchanged. In most areas, it was filled with new apartments but a slightly larger increase was observed in the area of Patriarch Ponds. Today this district accounts for 7% of the total properties in comparison with 3% in September 2014. The biggest number of available high-budget apartments (23%) is still in the Arbat-Kropotkinskaya area. (27 ▶)

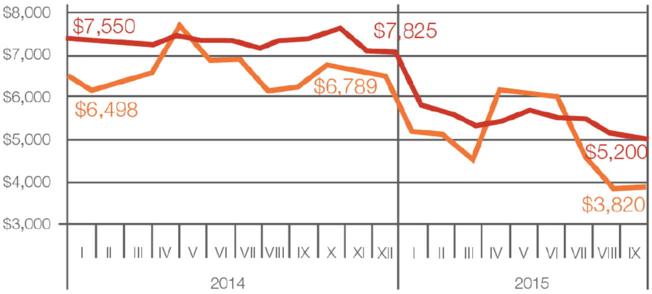
27 ▶ ANALYSIS OF THE MOST POPULAR AREAS IN MOSCOW IN TERMS OF SUPPLY



Source: Intermark Relocation

RENTAL RATES AND BUDGETS

28 ▶ DYNAMICS OF THE AVERAGE BUDGETS OF SUPPLY AND DEMAND



Source: Intermark Relocation

• Average property budget: USD 5,200 per property per month. It has fallen 31% since January in stark contrast with last year's stable figures.

• Interest rates began to slide in November 2014 and had stalled by May when the exchange rate stabilised at RUR 52–55 to the US dollar. A more gradual decline continued this summer with a drop of 11% over three months.

• The current rental rates were last recorded in 2009.

• The average budget of demand has been more volatile in 2015. Since the beginning of the year, it has been on a downward trend, following the revision of rental rates by landlords. However, between April and May supply and demand budgets found near-equilibrium due to the temporary strengthening of the rouble exchange rate and its conversion to dollars. Nevertheless, the latter period still showed a 10% difference in comparison to last year's stable level.

• Supply budgets witnessed a strong correction in the Krasnaya Presnya, Frunzenskaya and Chistye Ponds areas by the end of September 2015, and to a lesser degree in the Kutuzovsky Prospekt, Tsvetnoy Boulevard and Zamoskvorechye areas. (29, 30 ▶)

29 ▶ ANALYSIS OF RENTAL RATES CHANGES BY DISTRICTS IN MOSCOW

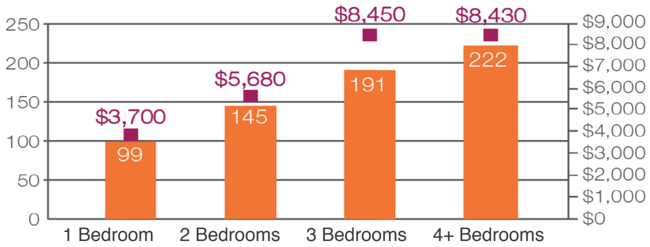
	The whole market	Arbat-Kropotkinskaya	Patriarshie Prudy	Tverskaya-Kremlin	Lubyanka-Kitay-Gorod-Chistye Prudy	Zamoskvorechye	Frunzenskaya
Sept. 2014	$7,520	$9,940	$8,290	$7,670	$7,380	$6,910	$6,800
Sept. 2015	$5,200	$6,620	$4,890	$4,730	$4,060	$5,470	$3,350
Changes, %	-31%	-33%	-41%	-38%	-45%	-21%	-51%

	The whole market	Krasnopresnenskaya	Tsvetnoy Boulevard	Taganskaya	Leninsky Prospect	Kutuzovsky Prospect	Kuntsevo
Sept. 2014	$7,520	$8,185	$6,380	$4,770	$5,590	$5,980	$6,150
Sept. 2015	$5,200	$3,930	$4,750	$1,940	$3,620	$4,960	$3,960
Changes, %	-31%	-52%	-26%	-59%	-35%	-17%	-36%

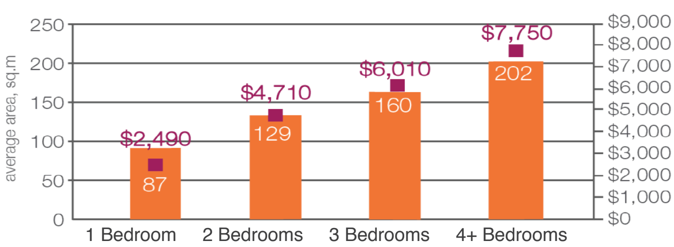
Source: Intermark Relocation

30 ▶ ANALYSIS OF RENTAL BUDGETS IN AREAS WITH THE BIGGEST SUPPLY

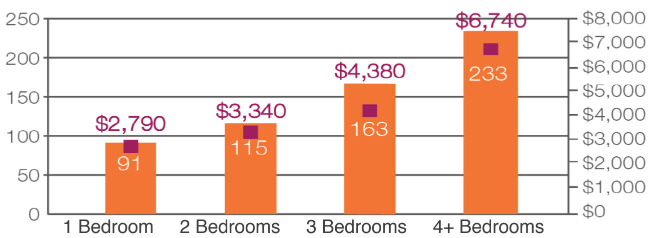
Arbat-Kropotkinskaya



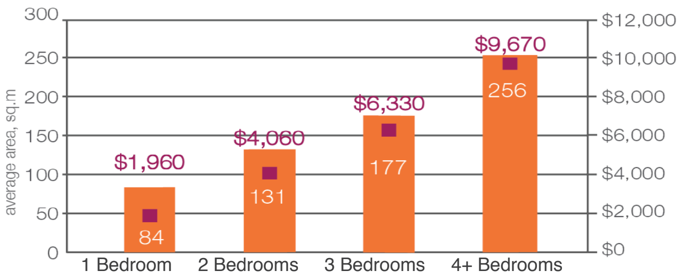
Tverskaya-Kremlin



Lubyanka-Kitay-Gorod



Zamoskvorechye



Source: Intermark Relocation

St. Petersburg market overview

Office market

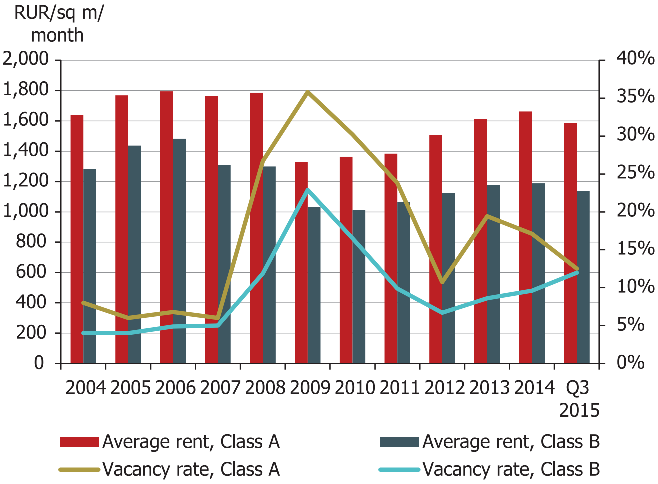
In Q3 2015, the modern office stock (Classes A and B) in St. Petersburg increased by 74,530 sq m with 5 office buildings delivered to the market. One completed business centre was the Class A building Flandriya Plaza BC, with a leasable area of 33,000 sq m. Other buildings were Class B, with a total leasable area of 41,530 sq m. Total completion levels in 2015 are expected to be at around 200,000–210,000 sq m, but we forecast decreasing completion levels in 2016. We forecast a fall in 2016 with completions expected at around 150,000–160,000 sq m.

Net absorption in Class A and B office centres in Q3 2015 amounted to 76,830 sq m, which is the highest third quarter level on record. This high level of net absorption was due to a number of Gazprom deals that took place in the new office centres Flandriya Plaza BC and Mezon Plaza BC. The net absorption was the highest on record in both classes. Q1–Q3 2015 there was significant activity among mining and exploration companies (50% of all deals), and the construction sector and information technology sector.

According to the results of Q3 2015 the vacancy rate decreased by 0.5 pps to 12.1%. In Class A the vacancy rate for the quarter decreased by 1.6 pps to 12.5%, while in Class B it increased by 0.2 pps to 12.0%.

During Q3 2015, rental rates in Class A increased by 1.6%. In Class B rents decreased by 0.9%. In Q3, the average asking rental rate in roubles amounted to RUR 1,590 per sq m/month in Class A and RUR 1,140 per sq m/month in Class B (including VAT and operating expenses). (**31 ▶**)

31 ▶ BASE RENTS AND THE VACANCY RATE IN THE ST. PETERSBURG OFFICE MARKET



Source: JLL

Retail market

There were no shopping centres delivered to the market in Q1–Q3 2015. The volume of quality retail space totals 2,147 mln sq m. Future completions for 2015 total 42,400 sq m. The volume of retail space announced for 2015 is the lowest since 2009 (only slightly higher than in 2009), and 50–80% less than in the last five years. The volume of projects announced for 2016 is a bit higher, but also less than in the last six years, except 2015.

Over the first eight months of 2015 real income decreased by 9.0% YoY. Retail turnover and wholesale turnover decreased from January–August 2015 by 10.4% and 13.9%, respectively. Restaurant turnover fell by 5.5% in the same time period.

For the first time in 2015, the share of fashion retailers in newly opened premises during the last quarter in shopping centres reached more than 50%. In respect of restaurant and fashion retailers, more premises were opened than closed. The total volume of closed premises was 20% more than the volume of opened premises, so vacancy rates increased in Q3 2015.

The vacancy rate increased by 0.1 pps at the end of Q3 2015 and totals 6.6%. The prime base rental rates in quality shopping centres decreased to USD1,200 sq m/year.

In most cases in St. Petersburg shopping centre rents are denominated in roubles or turnover rent is applied. (**32 ▶**)

32 ▶ RENTAL RATES IN ST. PETERSBURG SHOPPING CENTRES

Type	Area (sq m)	Rental rate* (USD/sq m/year)
Hypermarket	> 5,000	100–130
Supermarket	1,000–2,500	150–300
DIY	8,000–15,000	80–100
Fitness clubs	2,500–5,000	60–90
Household goods	<2,000	80–100
White & Brown	2,000–3,000	80–150
Sport goods	>4,000	70–100
	800–1,500	110–160
Cinema	>3,000	70–120
Entertainment	2,000–3,500	60–90
	1,000–2,000	80–110
Perfume and cosmetics	300–500	400–750
	50–100	600–1,000
Goods for children	>1,000	140–200
	<150	500–900
Food courts	40–150	700–1,200
Restaurants	250–600	250–400
Shoes	<100	600–1,200
	100–250	500–1,100
	>250	250–500
Fashion and apparel	1,500–2,500	90–160
	400–1,200	130–400
	100–300	250–800
	<100	500–1,200

* Rents are given excluding VAT and operating expenses. Rents are given for new lease agreements, and do not consider individual discounts.

Source: JLL

Street-retail market

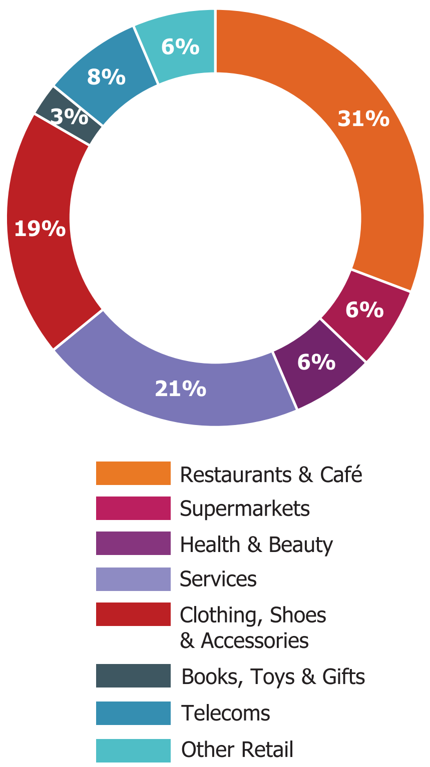
Rotation on the main street-retail corridors in Q3 2015 also reduced significantly and totaled 4.6%, which corresponds to the level of Q1 2015.

In Q3 2015, for the first time since the beginning of 2015 we observed a decrease in the quantity of free premises on the street retail market. The vacancy rate reduced by 0.6 pps on the main street retail corridors and was equal to 8.2%.

In Q3 2015, 23% more premises were opened than closed. Restaurants and cafes dominate in terms of retailers who entered the market in the quarter, at 30%. Equally, restaurants and cafes were the most numerous to leave the market.

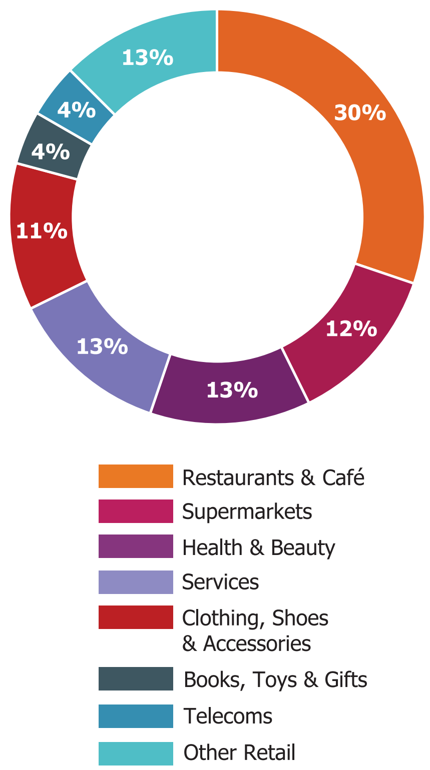
The number of fashion retailers is declining, and the share of retailers that closed shops totaled 19% (22% in Q2 2015) with only 11% opening new shops (13% in Q2 2015). (**33, 34** ▶)

33 ▶ CLOSED PREMISES IN Q3 2015 BY RETAIL PROFILES (NUMBER OF RETAIL UNITS)



Source: JLL

34 ▶ OPENED PREMISES IN Q3 2015 BY RETAIL PROFILES (NUMBER OF RETAIL UNITS)



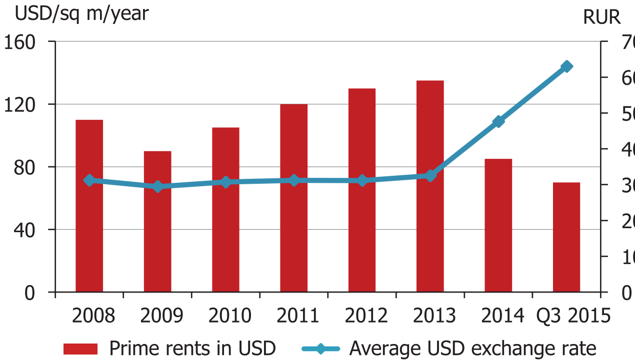
Source: JLL

Warehouse market

There were no warehouse complexes delivered to the market in Q3 2015. The total volume of quality warehouse space is equal to 2,485 mln sq m. About 99,000 sq m are set to be completed in Q4 2015. 300,000 sq m more will be delivered to the market in 2016.

The share of owner occupied warehouse complexes continued to grow in Q1–Q3 2015 (25% of all warehouse space by the end of Q3 2015, compared with 21% by the end of 2013 and 23% by the end of 2014). The share of owner occupied warehouse complexes will reach 31% by the end of 2016, mainly due to the increase in the number of built-to-suit projects.

35 ▶ PRIME WAREHOUSE RENTAL PRICES IN ST. PETERSBURG



Source: JLL

In Q1–Q3 2015, net absorption reached 71,700 sq m (171,600 sq m in Q1–Q3 2014). In Q3 2015, only 15% of the total volume was absorbed. Net absorption in July–September 2015 was the lowest third quarter result in the last six years. The total take-up in Q1–Q3 2015 reached 185,600 sq m (292,300 sq m in Q1–Q3 2014). In Q3 2015, 36% of all deals were concluded. In the third quarter of 2015, the vacancy rate decreased to 6.4% (6.9% in Q2 2015).

In Q3 2015, the asking rental rates amounted to USD 65–70 sq m/year (without OpEx and VAT). Following high volatility in the rouble/dollar exchange rate, developers nominate rents in roubles. The average asking rates were equal to 500–550 roubles per sq m/month (including OpEx and VAT) in Q3 2015. (**35 ▶**)

Hot Topic:

"Must have" conditions for a lessee in a lease agreement

Ekaterina Lapidus
Partner, Real Estate and Construction Practice, BRANDI PARTNERS

Olga Ezhova
Senior Associate, Real Estate and Construction Practice, BRANDI PARTNERS

Currently, the "lessee-oriented market" prevails practically in all segments of the commercial real estate market. Nevertheless, when agreeing upon the terms of a lease, not all lessees demand inclusion in the contract of the key "must-have conditions" during negotiations.

The key "must-have" conditions for the lessee in the current context are as follows:

RUR RENTAL RATE INSTEAD OF USD AND PROHIBITION ON INDEXATION OF RENTAL RATE

Due to the existing financial and economic factors, in current commercial real estate transactions the rental rates are increasingly frequently fixed in roubles (or in USD, but with a fixed RUR-rate). Fixing the rental rate in roubles provides the lessee with the required financial guarantees, protecting it from possible abrupt fluctuations in the exchange rate in the future. Today, such rental rate fixing is probably one of the most important must-have conditions for the lessee. Although some lessors still insist on having the rental rate fixed in a foreign currency, most lessors are ready to fix the rental rate in RUR.

In addition, it should be noted that the current real estate market allows the lessee to demand even the prohibition on indexation of the rental rate.

BREAK-OPTION CLAUSE

A break-option clause in the lease is also one of the most essential must-have conditions for the lessee. The absence of such a clause entails the risk that the lessee (in the absence of violations on the part of the lessor) will not be able to withdraw from the contract. Ideally, the break-option clause should not entail any penalties for the lessee, and the right to withdraw from the contract should be granted to it at any time in the duration of the lease. But as agreeing upon an "ideal" break-option clause with the lessor is practically impossible, the lessees, as a rule, have to agree that they will be entitled to exercise this right only after a certain amount of time has passed since the contract was entered into (generally, two, three or five years depending on the length of the lease contract).

SANCTIONS CLAUSE

Due to the introduction of the economic sanctions in respect of Russia, it is extremely important for the lessee to have the so-called "sanctions clause" included in the contract. The risk the lessee faces is that in case sanctions are introduced in relation to the lessee's company, or in case a prohibition or restriction on the trade of certain goods is imposed, the lessee will remain bound by the lease, which will become unwanted or unbeneficial because of it. A correctly formulated sanctions clause will eliminate such risk: in case of the introduction of the respective sanctions (they should be described in the contract in every possible detail!) it will allow the lessee to terminate the contract, and therefore the lessee will be protected from unnecessary expenses. In this respect the sanctions clause is especially important for foreign retailers.

"LEASE VACATIONS" (RENT FREE PERIOD) FOR FINISHING

Inclusion of the so-called "lease vacations" (rent free period) in the contract is a must-have condition for the lessee in case the premises are leased in shell & core condition, or in case it is necessary to design the premises for the purpose of the lessee's business. Commercially, "lease vacations" mean that during a certain period of time – generally, two or three months after the parties enter into the contract – the lessee should be released from payment of the entire rental amount or most of it thereof (as during this period the premises are used by the lessee solely for carrying out finishing work). As a rule, the lessors agree to have the relevant provisions included in the contract. However, it is important for the lessee to conduct negotiations correctly to agree upon the most favourable commercial terms of such "vacations".

OPPORTUNITY TO TERMINATE THE CONTRACT DUE TO "MATERIAL CHANGE OF CIRCUMSTANCES"

The opportunity to withdraw from the contract due to "material change of circumstances" (under Article 451 of the Civil Code of the RF) is another "backup" option for the lessee who might need to terminate the contract in case the lease becomes a significant financial problem for the lessee. Although the existing court practice shows that lessees are able to withdraw from the contract on such grounds only in very exceptional cases, given the current conditions it is extremely important for the lessee to have such a protective option – especially in case of the absence of the break-option clause.

A COMPLETE LIST OF LESSOR VIOLATIONS AS GROUNDS FOR EXTRA-JUDICIAL CONTRACT TERMINATION

In case the lessor does not agree to grant the "break-option clause" to the lessee, it is recommended to include in the contract a complete list of lessor violations, which grant the lessee the right to preliminarily terminate the contract. Firstly, this list will restrain the lessor from bad conduct. Secondly, it will allow the lessee to refer to the lessor violations in order to terminate the contract if necessary. Herewith, it is very important to specify in the contract that in case of such violations on the part of the lessor, the lessee shall have the right to unilaterally withdraw from the contract in extra-judicial procedure.

ABSENCE OF THE "FAIR TERMS" CLAUSE IN THE CONTRACT

It is also extremely important for the lessee not to specify in the contract that the terms thereof are accepted by the lessee as "fair" ones. It is essential because in case the lessee needs to withdraw from the contract, it should be able to refer in court to the fact that the contract contains "unfair contractual terms", and the lessee turned out to be a "weak party" thereto (as it was deprived of the opportunity to agree upon such terms). Though the concept of "unfair contractual terms" is a new one, and there are not so many cases of it being effectively applied, it is highly recommended for the lessee to include such a "loophole" in the contract.

All of the above considered, it should be noted that the formulation of the terms and conditions of the lease will affect the lessee's whole "life" with regard to the contract. For this reason, at the stage of the contract preparation and negotiation, the lessee should think out every minor detail. Omission of any of the must-have conditions mentioned above can prove very costly for the lessee. And vice versa: the timely and well-considered inclusion of the said terms in the contract can help the lessee to draw up a contract that provides the most benefit and get through the tough economic times.

Hot Topic:

Changes in land rental procedures – implications for business

Maksim Popov
Associate Director,
Goltsblat BLP LLP

Since the early days of the Russian land reform, lease rights to a state or municipal land plot have been widespread as assets entitling the leaseholder to implement an investment project. There are a number of important factors behind this, i.e.:

• The legislation has treated leasing as the pre-eminent method for managing public land, with sale and purchase being possible only in a very limited number of cases. A typical example is Moscow, where, until the end of the last decade, it was virtually prohibited to sell land plots even when expressly permitted by federal legislation.

• The procedure for leasing out land plots was fairly simple and not subject to much regulation. Whether or not a land plot lease could be concluded depended largely on how good the relations were with the authorities.

• Generally, there was no limit on the length of land leases, so long term leases, including for 49 years, could be concluded for building and then operating real estate projects. Moreover, the legislation secured the pre-emptive right to enter into a new lease.

• It was a long time before the federal authorities finally approved the Land Plot Permitted Use Classifier. In the absence of land use and development rules, this meant that local authorities could include overly broad wordings in land plot leases, such as "for constructing an administrative and office, production and warehousing or shopping and entertainment centre". Even if the recipient of the lease was not satisfied with how the permitted use was expressed, the wording could easily be amended by decision of the local authority.

• Nor was it difficult to make lease assignments (i.e., lease SPAs). In many cases, assignments were even permitted without the landlords' consent, provided the landlord was notified.

• Finally, public land rental rates were, as a rule, relatively low and the administrative liability for not using a land plot fairly lenient. All this meant that leased land plots could be held in abeyance for a buyer for a long time.

Consequently, there has always been an abundance of leased public land plots on the market, and the options considered by companies intending to implement an investment project quite frequently included not only the outright purchase of a publicly or privately owned land plot, but also the acquisition of the rights and obligations under a public land lease agreement.

On the other hand, over the last few years, there has been a clear tendency for public land plot lease rights to be divested of the features of an investment asset. This is a result of both legislative developments and court practice. Below we describe the most visible signs of this trend:

One of the first "alarm bells" was most certainly rung by Resolution No. 1756/13, dated 25 June 2013 of the Praesidium of the Supreme Commercial Court of the Russian

Federation, which substantially limits the ability to alter the type of permitted use of a public land plot for property construction purposes. The court is of the opinion that, in practice, the actual purpose of altering the type of permitted use of a land plot from the operation of one facility to the construction of another is to circumvent the procedures set forth in the legislation for allocating land plots for property construction, including competitive bidding for previously created land plots registered in the state real estate cadastre.

Then Federal Law No. 171-FL, dated 13 June 2014 "On Amendments to the Russian Land Code and Certain Legislative Acts of the Russian Federation" (hereinafter "Law No. 171-FL") was enacted, which mostly came into effect on 1 March 2015. Its two major developments are as follows:

Firstly, maximum lease terms were established for constructing or reconstructing buildings or structures. If a land plot is allocated without competitive bidding, the lease is concluded for 3 to 10 years, as the tenant wishes. The term of an auction-based lease is currently 1.5–9 years, with any pre-emptive right to renew the lease without competitive bidding being precluded. In a limited number of cases, this right is replaced by the ability to conclude a new lease for the land plot without competitive bidding. In any case, the term is far less than the previous 49-year leases, so you will no longer be able to "hold on to" an undeveloped land plot for long.

Secondly, in line with the position taken by the Supreme Commercial Court of the Russian Federation, it has been clearly legislated that no changes to the permitted use of a land plot may be made in a publicly-owned land plot lease concluded by bidding (or if a bid is recognised as not having taken place). Even though the law does not expressly ban a change to the type of permitted use of a land plot leased out without competitive bidding, such a ban is obviously implied, since the very possibility of a land plot being leased without competitive bidding depends on the objectives specified in the law.

Then, in late 2014, the Land Plot Permitted Use Classifier, as approved by the Russian Ministry for Economic Development, took effect. This document is designed to limit the powers of local authorities to take decisions on setting land plot allocation objectives.

In March 2015, amendments were made to the Russian Code of Administrative Offences. These introduced considerably more stringent liability for failure to use a land plot intended for residential or other construction purposes. So now, instead of symbolic fines, companies face having to pay from 3 to 5% of the land plot cadastral value but no less that RUR 400,000 (part 3, article 8.8 of the Code of Administrative Offences). Given the constantly growing cadastral value of land plots, if a land plot is not developed but put on hold for a long time in anticipation of a buyer, this might now entail very significant financial losses or, in the worst case scenario, even forfeiture of the land plot.

Finally, since 1 June 2015, the new version of article 448 of the Civil Code of the Russian Federation has brought into question the very possibility of assigning lease rights to publicly-owned land plots. The article stipulates that if, by law, leases may only be concluded through competitive bidding, winners may not assign their rights or novate the debt under the obligations arising from the lease. As we know, pursuant to Law No. 171-FL, dated 1 March 2015, land plots for building commercially attractive real estate projects are to be allocated specifically by bidding, so the rights and obligations under leases concluded on this basis may not be assigned to third parties. On the other hand, clause 9, article 22 of the Land Code of the Russian Federation remains in effect, allowing any long term lease for public land to be assigned. The conflict between the two codes will evidently be eliminated by judicial practice.

Summarising all these trends, we can say that federal legislation and relevant court practice are currently designed to divest the lease rights to public land plots of their investment features. The lease of such land plots has a specific purpose and is individual in nature at this stage. In other words, leases are exclusively intended to ensure that the construction of the facility they specify is completed in due time by the land plot recipient. Should all these trends materialise, there would be a gradual but considerable drop in the number of transactions involving public land lease rights. Presumably, there would also be a proportionate rise in the number of acquisitions of corporate land tenants ("share deals") and of more complex structures involving the termination of an existing lease, followed by the investor acquiring the land plot from the authorities in the usual manner.

Hot Topic:

Investing in the mass residential market segment: is it worth it?

Teemu Helppolainen
Head of "Housing, Russia" business-segment, YIT Group

The interest of foreign investors in the Russian real estate market is continuing to decline for the second year in a row.

Investing in the real estate market has typically meant investing in commercial premises. However, the commercial real estate world is large enough. And in today's circumstances, it makes sense for the potential investor, who is considering the Russian real estate market as a serious tool, to pay more attention to the mass housing market.

Why is mass housing attractive? The answer lies on the surface. In times of crises the expensive real estate segment is the most strongly affected due to the fact that all consumers firstly cut expenses on products that are not essentials. In contrast, the mass segment is continuously in demand, even during a crisis. Demographic trends remain the same: meaning a decrease in the size of households and increase in number thereof.

According to the Federal Service for State Registration, Cadastre and Cartography, from January to October of this year in the primary market of Moscow 18.3% less transactions were registered than during the same period in 2014. Compared to the total number of transfers of property titles, where the drop amounted to exactly one third, this figure does not look so depressing. It should be understood that the figure of 18.3% takes into account the luxury and business class housing segment, where there has been a rather serious decline in demand. On the contrary, in the mass segment the decrease in the number of buyers has been minimal, and developers who offer the buyer really high-quality products were able to keep the volume of transactions at a pre-crisis level as a whole, including the mortgage transactions.

Another indicator to be considered for the mass market segment without reference to the real estate market as a whole is the price. All analysts, without exception, say that the average cost per square meter of residential real estate in most parts of Russia has significantly decreased over the past year. And this is true for the market as a whole. However, in the mass housing market, the situation does not look so critical.

The macro-economic (as well as political) situation today is such that a further weakening of the rouble at such a rapid pace is unlikely to happen. Even if the negative trend continues it will not peak as it did in 2014. Thus, the risk of a further decrease in the equivalent cost of square meters in US dollars or euros as much as during last year is minimal. Most likely, for some time prices will remain at the same level, and then, when the economy begins to emerge from the crisis after the price increase in roubles, the price increase in foreign currency will follow.

The result is that foreign investors willing to invest in the Russian real estate market today are in a very advantageous position. Despite the decline in the value of the rouble against the world's currencies by almost 2 times during the last 1.5 years, the prices in roubles for construction materials and labour have been growing much more slowly in the domestic market. Thus, the market entry threshold with capital in foreign currency has declined; and today it is rather different sum of money than a year ago.

Therefore, for companies interested in long-term investments, it is a really good time to begin. In several years, when the crisis ends and the housing market bounces back, investments made today can give a really high profit. As is evidenced by our extensive experience in this market, all crises end sooner or later; and high-quality housing at an affordable price is always in demand.

20 years

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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, State Duma and other relevant governmental bodies.

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