2017 Moscow

Office market review

S.A.Ricci

General Trends and Developments

- During the last 2 years, the market is experiencing a demand of high intensity at the level of 900,000 sqm annually. Over the past 2 years, 40% of office areas built in the Moscow International Business Centre (MIBC) were acquired and leased. As for the territorial structure of demand, the Third Ring Road zone (TRR) traditionally dominates (over 45%). However, 30% of deals in the Garden Ring zone indicate a centripetal trend of demand in the Moscow office.
- The new supply is more than 2 times less than demand. A half (200,000 sqm) of new office areas was supplied only in Q4 at MIBC, i. e. long-awaited projects “from the last decade” were launched.
- High demand and low development activity led to a decrease in the average market vacancy rate by 3 pp to the level of 13.8%. In 2018, we expect that the existing trend will continue: the vacancy rate will drop additionally by 2-3 pp. At the same time, the vacancy rate will fall below the benchmark threshold of 10% in the Boulevard Ring, Garden Ring and TRR zones.
- In 2017, there was a slight adjustment of the rental rate to the downside compared to y-o-y. The trend is due to high demand and “washing out” of the most high-quality and expensive office areas from the market. In 2018, we expect an adjustment of the rate to the upside.
- Office facilities remain the most demanded investment asset on the capital market with a share of 40%.

Indicator of 2017	Class A	Class B+	Class B
New supply, thousand sqm	338	54	0
Volume of transactions, thousand sqm	500	304	84
Vacancy rate	16.1%	16.0%	7.9%
Rental rates*, rub/sqm/year	23,100	13,200	12,100

** the rates are indicated for shell & core premises, excluding VAT and operating expenses*

Investment Market

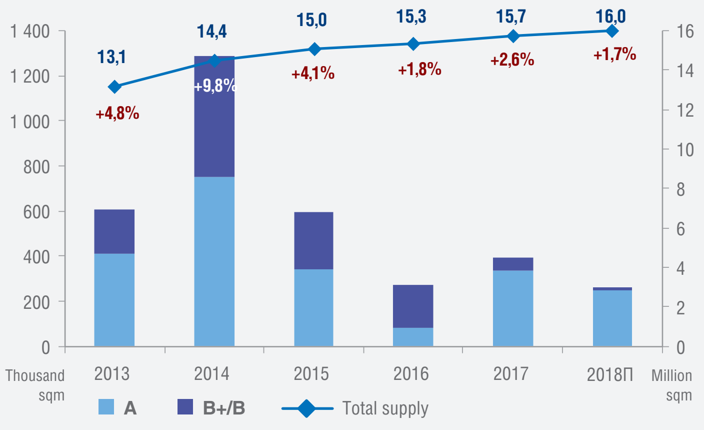
▮ In 2017, office facilities traditionally remained an attractive asset for investors, raising $1.8 bln in investments (40% of the total amount). Given the overall decrease in the investment activity compared to y-o-y, the volume of investments decreased by almost 50% (in 2016, the volume of investments was $3.5 bln).

▮ In 2017, Moscow and St Petersburg became popular among investors. The investment in the capital was $1.6 bln. The most “expensive” deal was the acquisition of Multifunctional Complex IQ-Quarter (MFC IQ-Quarter) by the Agency for Housing Mortgage Lending (AHML) (74,000 sqm). The amount of the deal made $430 mln. In St Petersburg, the acquired office areas were worth of $147 mln. It should be noted that (as in 2016) office facilities were not purchased in the regions.

▮ Russian investors acquired office facilities worth of $1.5 mln. Last year’s indicator was 2 times higher and amounted to $3.4 mln. In 2017, foreign companies purchased 100,000 sqm of office premises for the total amount of $245 mln.

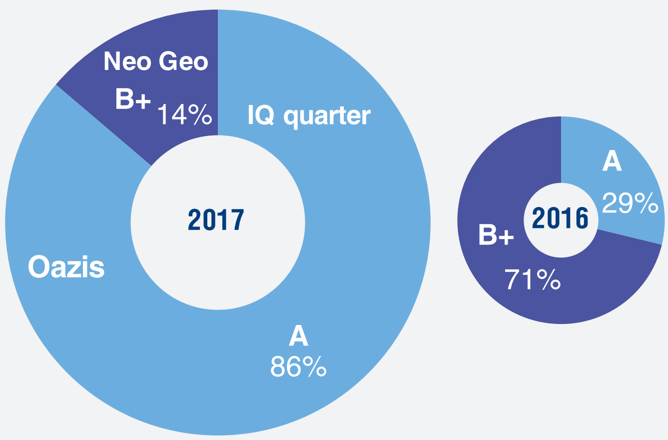
▮ The capitalisation rate was 10–10.5% as of the end of 2017.

New supply increment dynamics at the Moscow’s office market



Source: S.A. Ricci

Structure of supply by classes



Source: S.A. Ricci

Supply

▮ In 2017, the volume of new office areas in the office market amounted to 390,000 sqm, which is almost half (43%) higher than in 2016 (274,000 sqm).

▮ By the end of 2017, the total supply of office areas increased by 2.6% and amounted to 15.7 mln sqm.

▮ Developers were most active in Q4 2017 – 50% of the total volume of new supply was supplied: three new facilities entered the market (IQ Quarter, Kvadrat and launch blocks 2, 3 in the Federation Tower), with a total area of 211,000 sqm.

▮ In 2017, developers brought to the market mainly Class A office facilities (86% of the total volume – 338,000 sqm). Last year, the volume of the new supply was, in contrast, formed mainly due to B+ business centers (71%). In 2017, 54,000 sqm of Class B office premises were supplied, which is 14% of the total volume.

▮ As for the territorial structure of the new supply, the MIBC zone accounted for 52% of the total volume (202,000 sqm). The volume was formed due to the supplying of two business centres: IQ-Quarter and some premises in the Federation Tower. For the last three years, new office areas were supplied in the MIBC zone for the first time.

▮ In the distribution of the new supply by the ring zones, the Third Ring Road (TRR) continues to be of interest to developers – 85,000 sqm (22% of the total volume). In 2016, the TRR zone was leading in terms of the volume of the new supply – 59% and 162,000 sqm in absolute terms.

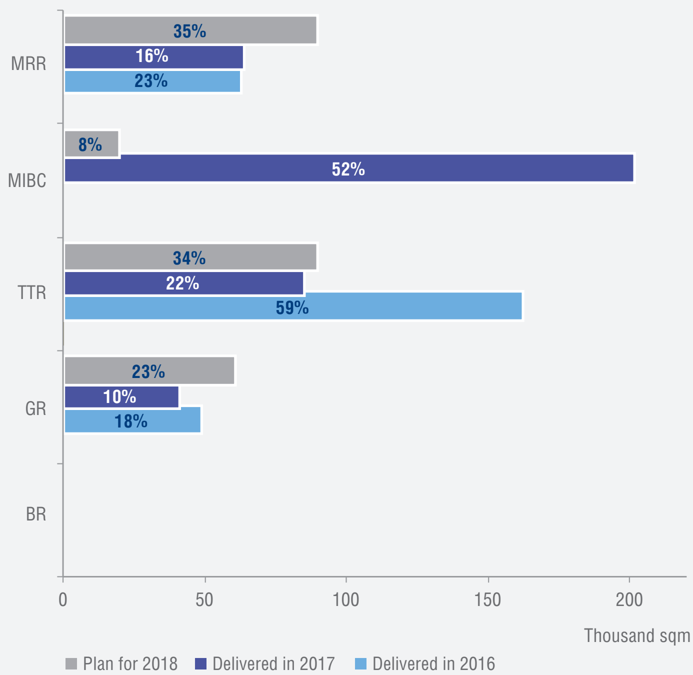
▮ As in 2016, the volume of the new supply in the Moscow Ring Road zone (MRR) amounted to 64,000 sqm. The volume was formed mainly by two Class A business centres (Neopolis, Kvadrat). Within the Garden Ring, 41,000 sqm entered the office market, which is 17% less than in 2016 (49,000 sqm).

▮ In terms of breakdown by administrative districts, the leader of the year 2017 is the Central Administrative District (CAD), where 62% of the total premises (243,000sq m) were supplied. The CAD dominance reflects the tendency of the office market to centralise. A significant amount of the new supply in this location is due to the supplying of the premises in the MIBC zone. It is noteworthy that IQ “left” the market before it was supplied: Rosselkhozbank and AHML bought 44,000 sqm and 74,000 sqm, respectively.

Examples of business centres supplied in 2017

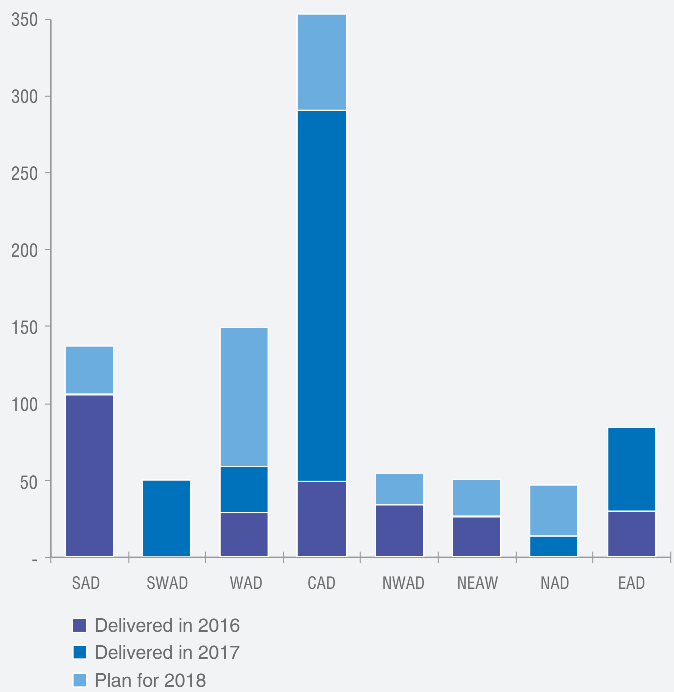
Name	Address	GLA, thous. sq. m	Class	Supplying date
Neo Geo	Butlerova str. 17	50,000	B+	1 Q 2017
Neopolis	Kievskoe Highway, 3 km from MKAD	54,000	A	2 Q 2017
Oazis	Koroviy Val street, 5	37,000	A	3 Q 2017
IQ quarter	Presnenskaya nab., 10	123,000	A	4 Q 2017
Tower Federation (2, 3 blocks)	Presnenskaya nab., 12	79,000	A	4 Q 2017

New supply distribution by ring zone



Source: S.A. Ricci

New supply distribution by administrative district



Source: S.A. Ricci

▮ The share of the new supply in the South-West Administrative District was formed by BC NEO GEO alone (50,000 sqm) and accounted for 13% of the total volume.

▮ According to developers, the supplying will be reduced by 35% in 2018 and will amount to 260,000–300,000 sqm of new office areas. Note that 95% of the planned new premises will belong to Class A.

▮ Office market supply leaders in 2018 will be MRR and TRR: in these zones it is planned to supply 90,000 sqm. It is noteworthy that 3 facilities declared for supplying are located in Skolkovo, and one business centre is located in the territory of the transport hub.

According to our forecasts, the aggregate volume of the new supply will increase by approximately 1.5–2.0% in 2018, and the supply of new office areas will be at the level of 260,000–300,000 sqm.

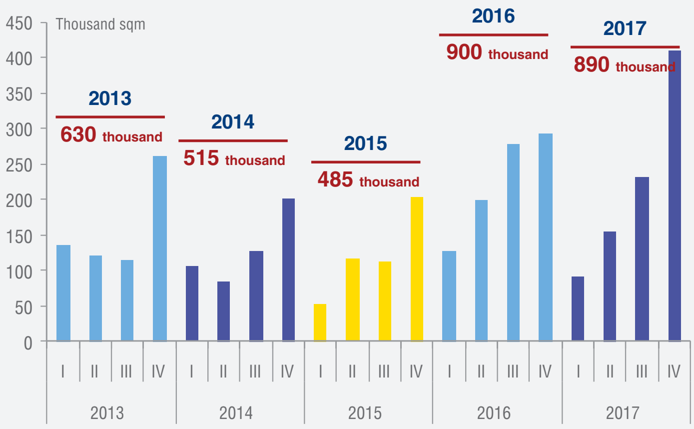
Examples of business centres to be supplied in 2018

Name	Address	GLA, thous. sq. m	Class	Supplying date
Amalteya	Skolkovo	35 000	A	1Q 2018
Novion	Samarskaya str., bld.1	21 000	A	1Q 2018
Oko (block B)	1st Krasnofvardeyskis avenue., 21, bld.1	20 000	A	1Q 2018
Stratos	Skolkovo	32 000	A	3Q 2018
Huamin	Vilgelma Pika str., bld. 14	25 000	A	3Q 2018
Orbion	Skolkovo	23 000	A	3Q 2018

Demand

During the last 2 years, the volume of demand is approaching 900,000 sqm. With respect to the last year, the indicator was adjusted by the statistical 1.2%, however, it exceeds the indicators of 2014 and 2015 by 70% and 80%, respectively.

Demand dynamic



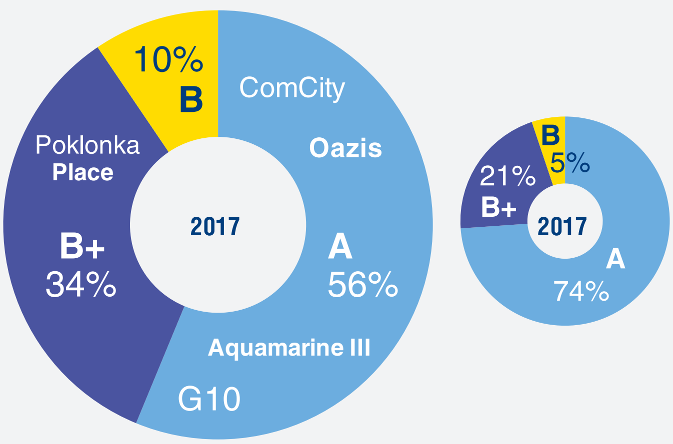
Source: S.A. Ricci

Traditionally, the last quarter became most active: in Q4 2017, 410,000 sqm of office premises were bought and leased, accounting for almost half (46%) of the annual volume of deals. It is noteworthy that the share of demand was 476,000 sqm for 9 months.

By the end of 2017, demand for Class A office premises (56% of the total volume) prevailed, which in absolute terms was almost 500,000 sqm. This value is 17% lower than in the previous year – 600,000 sqm. In contrast, the share of Class B+ premises increased as part of demand and amounted to 34% (304,000 sqm) in 2017.

Considering the lease and purchase of premises by the type of deals, the lease traditionally prevailed over the sale. The

Structure of office space take-up by class



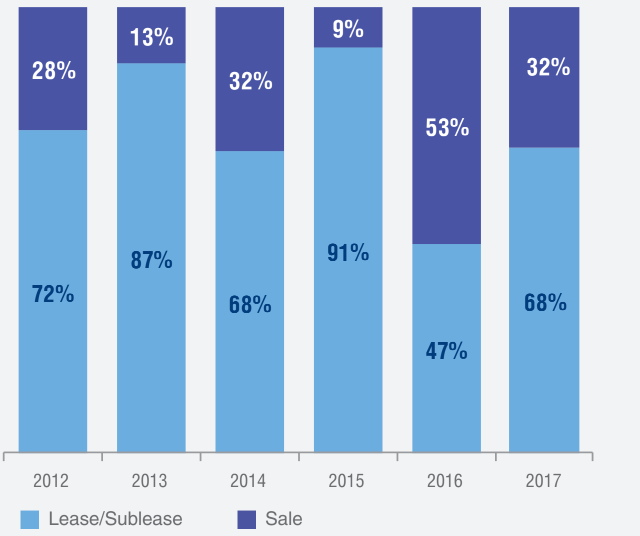
Source: S.A. Ricci

share of leased premises was almost 70% of the total volume, which in absolute terms is 600,000 sqm. In the previous year, the share of purchased premises was significantly higher (53% and 475,000 sqm), which was due to several major deals.

Over the last 5 years, we have seen an increase in the average deal size. In 2017, this indicator was approximately 2,100 sqm. On the one hand, the figure is 20% lower than the last year. However, with no account of the two largest deals in 2016 where banks sought to "buy out" pledge from their creditors (BC Eurasia and BC President Plaza), the average deal size in 2017 was 8% higher than the previous year indicator.

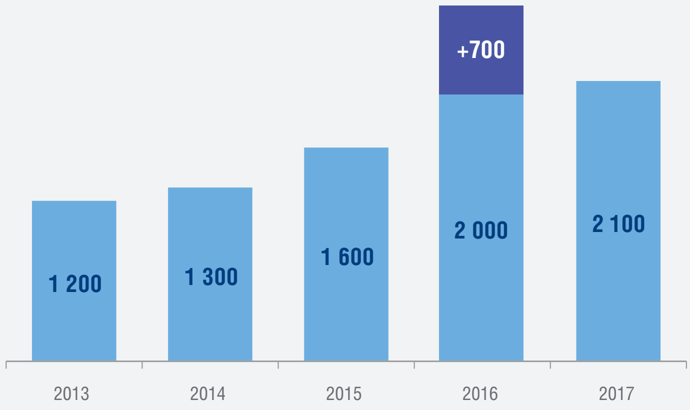
As for the territorial structure, there was a demand of high intensity within the Garden Ring – 260,000 sqm (30% of the total volume). Noteworthy is the permanent growth of demand in this zone since 2014 in absolute and relative terms.

Changes in the structure of take-up by transaction type



Source: S.A. Ricci

Avarege deal size



Source: S.A. Ricci

Key deals in 2017

Facility	Address	Class	Area, sq. m	Customer	Transaction type	Quarter
Incom City	1-y Krasnogvardeyskiy proezd.,7	B+	10 000	Russian Agricultural Bank	Sale	1Q 2017
3-st Tverskaya-Yamskaya str., 39	**3-st Tverskaya-Yamskaya str., 39**	**B+**	**4 200**	**Pepelyaev Group**	**Sale***	**2Q 2017**
ComCity	Kiyevskoye shosse 2 km from MKAD	A	13 000	Tele2	Lease	3Q 2017
Poklonka Place	**Poklonnaya str.,3A**	**B+**	**3 600**	**Snejnaya Koroleva**	**Lease***	**3Q 2017**
IQ-Quarter	Presnenskaya emb., 11	A	74 600	AHML	Sale	4Q 2017
Aquamarin III	Ozerkovskaya emb.,24	A	43 000	Gazprombank	Sale	4Q 2017
Poklonka Place	**Poklonnaya str.,3A**	**B+**	**4 300**	**Sberbank leasing**	**Lease***	**4Q 2017**

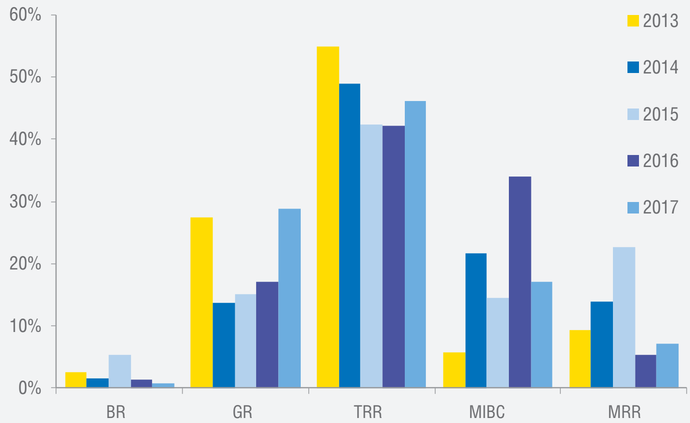
**S.A. Ricci deals*

▮ The TRR zone proved to be the traditional leader in demand intensity: 405,000 sqm were leased and bought (46% of the total volume).

▮ In the MIBC zone, the volume of deals made by the end of 2017 amounted to 150,000 sqm, which significantly exceeds the intensity within the period of 2013–2015. The indicator decreased more than 2 times compared to that of 2016, which was characterised by an abnormally high demand for premises in the MIBC. Over the past 2 years, 40% of all constructed premises were bought and leased in the MIBC zone.

▮ In 2017, demand in the MRR zone increased by 24% to 61,000 sqm, however, its share in the total volume was only 7%, as per the results of 2017.

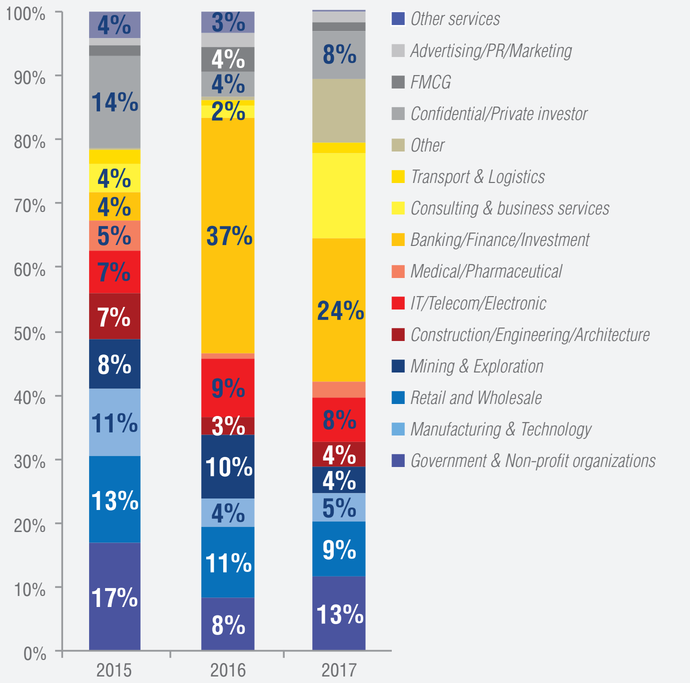
Dynamics of distribution of office space take-up by Moscow's ring zone



Source: S.A. Ricci

▮ As in 2016, the most active tenants and buyers by the end of 2017 were representatives of state-owned entities (103,000 sqm or 12% of the total volume) and financial organisations (200,000 sqm or 22% of the total volume). As of the end of 2016, the above two categories accounted for 45% of demand.

Structure of take-up by industry



Source: S.A. Ricci

According to our expectations, in 2018, demand will remain at a high level and amount to 700,000–900,000 sqm. The second half of the year will be the most intensive. Demand will be mainly driven by representatives of financial and state-owned entities, as before. Premises in the BC and TRRzones will meet the highest demand, but there will also be a high interest in the MIBC zone.

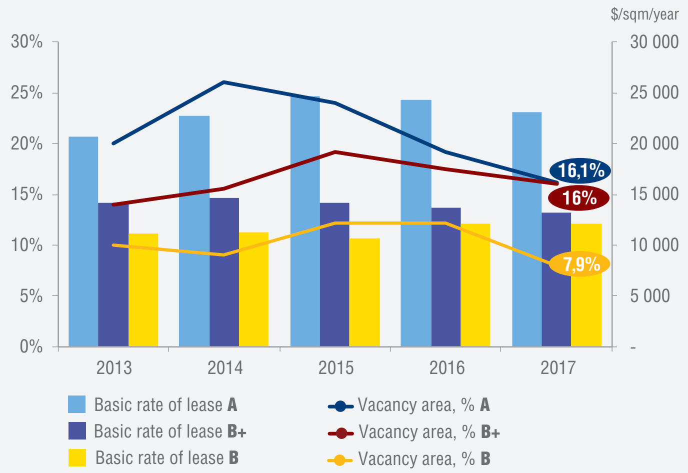
Vacancy

▮ Due to a rather high activity of tenants and buyers, as well as low supplying in recent years, a permanent decrease in the vacancy rate was observed for all classes in 2017. The average vacancy rate in 2017 in the office market was 13.9%, which in absolute terms is 2.2 mln sqm. To remind, by the end of 2016, the vacancy rate in the market of Class A, B+ and B premises was 17.1%.

▮ Following the results of 2017, the vacancy rate in Classes A and B+ almost equalled and amounted to 16.1% and 16.0%, respectively. In addition, we observed a more intensive decrease (by 3.1 pp) in Class A, and only by 2 pp in Class B+. The volume of vacant Class B premises showed the most intensive decline in relative terms by 4.2 pp to 7.9%.

▮ In terms of the breakdown by territory, the Garden Ring and TRR zones were leading in the vacancy reduction, since the vacancy rate dropped by 4.7 pp and 4 pp, respectively. According to the 2017 results, the minimum vacancy rate was established in the TRR zone (12%). In the Garden Ring and Boulevard Ring zones, the vacancy rate was below 13%. The volume of vacant premises in the MRR zone decreased to a certain extent, but still exceeds 19%. Despite the intensive take-up of areas, the vacancy rate changed to the upside and exceeded 17% based on the results of 2017 due to the supplying of new facilities in the MIBC zone.

Dynamics of vacancy and average weighted rental rates



Source: S.A. Ricci

In 2018, we forecast a decline in the average market vacancy rate by 2-3 pp to the level of 11-12%. At the same time, the vacancy rate will probably fall below the benchmark threshold of 10% in the Boulevard Ring, Garden Ring and TRR zones.

Rates

▮ In 2017, there was a slight adjustment of the rental rate to the downside. This is associated with the washing out of the most high-quality and comfortable premises, which leads to a statistical reduction in the average market level of the rental rate for the exhibited premises.

▮ According to the 2017 results, the weighted average rate was 23,100 roubles per sqm in Class A. This indicator is 5% below the level of 2016. It is to be recalled that by the end of 2016, the level of the rental rate in Class A was 24,300 roubles per sqm. However, the main decline in the rental rate was observed in the first months of 2017 (up to 22,000 roubles per sqm), then the rate remained stable, and in Q4 2017 there was a slight increase (+ 3%).

- The weighted average rental rate in Class B+ fluctuated within the range of 5% (13,200–13,800 roubles per sqm) during 2017 and reached the minimum level in Q4 2017. Based on the 2017 results, we note a decrease of 3% compared to y-o-y.

- By the end of 2017, the weighted average rental rate in Class B made 12 100 roubles per sqm. It should be noted that the rate changed during the year within the adjustment range – in absolute terms – by 200–300 roubles, and following the results of the year, we note a 1% growth relative to the indicator of 2016.

We do not expect any sharp changes in the rental rate in 2018. However, high demand and waning development activity will lead to a gradual increase in rates by the end of the year.

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