



H1 2014 WAREHOUSE MARKET REPORT Moscow

HIGHLIGHTS

- By the end of H1 2014, the volume of delivered high-quality warehouse space on the market of the Moscow region amounted to about 540 thousand sq m. This figure is 2 times bigger than for the same period of 2013.
- Plans of many potential warehouse tenants and buyers in H1 2014 were adjusted due to the economic uncertainty: the take-up volume in the Moscow region in H1 amounted to about 323 thousand sq m: almost 40% less than in H1 2013.
- By the end of H1, the vacancy rate grew by 2 p. p., reaching 3.9% against 1.9% at the beginning of the year. The growth of vacancy rates in ready-for-operation premises resulted from high volume of new supply in the North and Southeast of the Moscow region.
- Average supply rates in Class A warehouses are in the range of 120–130 \$/sq m/year (triple net).

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WAREHOUSE MARKET REPORT



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“At present, the market is going through one of its most difficult times primarily due to external factors: the political situation and the economy, which is largely dependent on the former. However, the development in the warehouse segment has not stopped: the regional development is advancing and the logistics optimization in the Moscow region is underway. The balance in supply and demand regulates lease rates, while growing struggle for customers leads to competition in quality. As for the time being attracting foreign funding and active involvement from major foreign investment funds on the investment market are hard to count on, the developers have to focus on the Russian money for the coming year or two. At the same time, due to the drop in demand, the list of companies involved in construction of logistics complexes may dwindle leading to further specialization of developer companies in this segment. On the demand side, distribution and trading companies will remain the driving force of warehouse market development in Russia. Already at this time, we can predict growth of several companies and optimization of their logistics flows, which will lead to large-volume transactions on the warehouse market”.

Key indicators. Dynamics

Indicator	Class A	Class B	Dynamics*
Total high-quality stock volume, thousand sq m	8,474		▲
including, thousand sq m	6,523	1,951	▲
Delivery in H1 2014, thousand sq m	540 (+6.8%)	–	▲
Expected supply growth in H2 2014, thousand sq m	500		▲
Take-up volume in H1 2014, thousand sq m	323		▼
Average vacancy rates, %	3.9	2.0	▲
Asking lease rates**, \$/sq m/year	120–130	100–110	▼
Operating expenses, \$/sq m/year	35–37	25–40	▶
Capitalization rates, %	11.25–11.5	11.0–12.0	▶

* Compared to H1 2013

** Triple net – excluding VAT, operational costs and utility bills

Source: Knight Frank Research, 2014



Supply

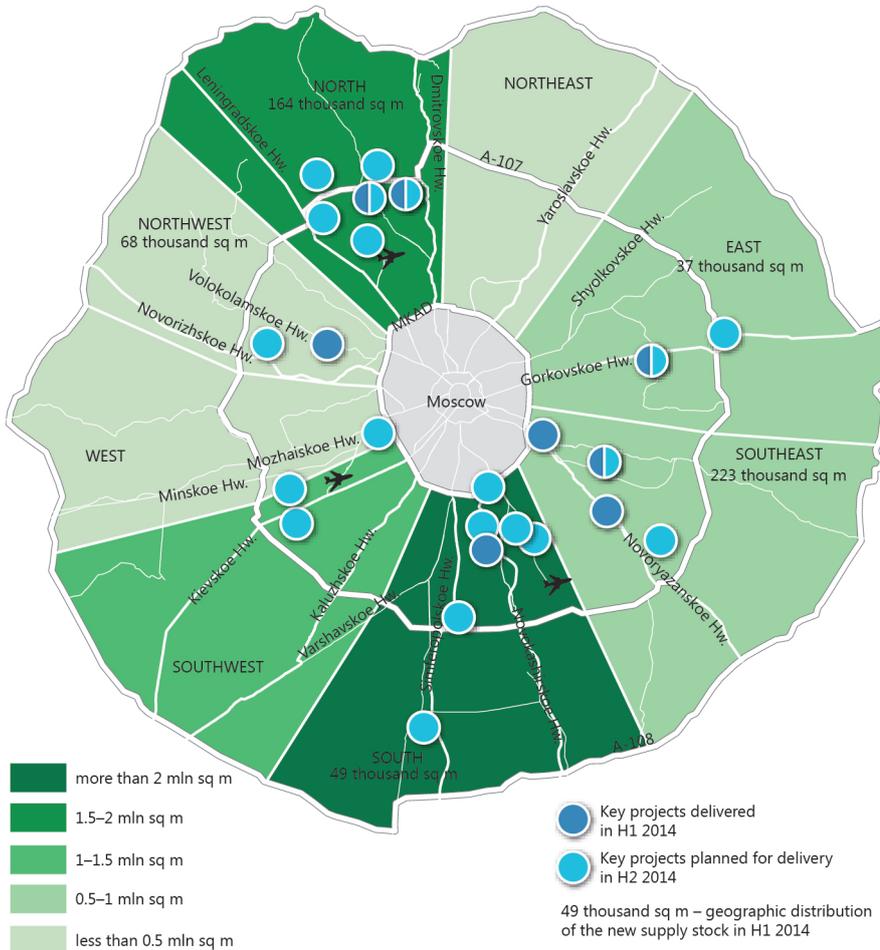
In H1 2014, high rates of construction activity could be observed on the market of high-quality warehouse space in the Moscow region: for the reported period, 540 thousand sq m were delivered, which is twice as much as for the same period the previous year. The new supply stock con-

sists by 62% of new-built objects and by 38% of scheduled stages delivery in existing complexes. It should be noted that for the first 6 months of this year, about a half of the volume expected for the entire 2014 was delivered.

North (between Leningradskoye and Dmitrovskoye highways, close to A-107

“Betonka” highway) and Southeast (Novoryazanskoye highway) of the Moscow region are the main directions of active warehouse construction this year. After half a year, these areas accounted for approximately 70% of the total delivery volume on the market of the Moscow region. The remaining 30% belong to the Northwest, East and South of the Moscow region.

The largest supply stock of available space in the ready-for-operation facilities is in the North and Southeast of the Moscow region



Active construction of warehouses in the Northern part of the region has several reasons. First of all, the Northern direction of the Moscow region is one of the key transport arteries through which goods from a number of European and Asian countries are delivered through the port of St. Petersburg to Moscow. Thus, the demand for warehouse space in this direction was traditionally quite high. However, for a long time, the bulk of supply stock here consisted of small and medium-sized storage facilities, as well as facilities built for own use, with the only major high-quality warehouse complex being the MLP Leningradsky Terminal (the total area of 197 thousand sq m).

High construction activity in the Southeast of the Moscow region is caused by a relative land plots relatively (compared to many other areas) low sale price. Moreover, a large-scale reconstruction of Novoryazanskoye highway is expected to enhance its capacity, thereby increasing interest for the direction in terms of warehouse development.

As to the territories of the New Moscow, at present, the development potential of warehouse real estate here is fairly low, as difficulties in obtaining permits for building and land plot category transfer continue to arise. It is worth reminding, that the general development plan of Moscow, which includes the annexed territories, and where issues of land zoning and the type of construction should be resolved, is still under development.

In H1 2014, the vacancy rate in Class A warehouse facilities amounted to about 3.9%, thereby growing by 2 p. p. since the beginning of this year. In absolute terms, the amount of vacant space in the Moscow region is about 257 thousand sq m. Thus, the vacant facilities supply stock has grown 1.7 times during H1.

It should be noted that the amount of vacant space in the North and Southeast of the Moscow region consists by 57% of new supply and by 8% in the East and Northwest. The remaining 35% of the total available Class A warehouse space stock are vacated the premises.

Demand

By the end of H1 2014, the total take-up of high-quality warehouse space on the Russian market amounted to about 513 thousand sq m. This is almost 30% less than in H1 of 2013, a year that set

Source: Knight Frank Research, 2014

Dynamics of take-up volume, new supply and vacancy rates on the highquality warehouse real estate market of the Moscow region

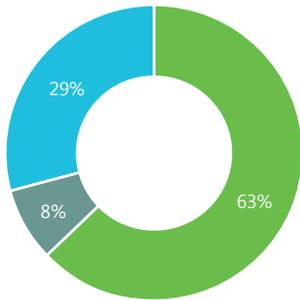


Source: Knight Frank Research, 2014

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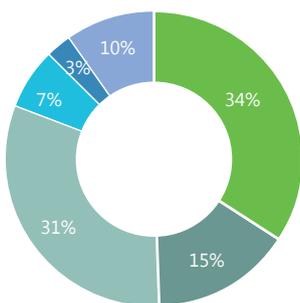
The lease and purchase transactions volume in the regional cities of Russia in H1 2014



- Moscow region
- St. Petersburg and Leningrad region
- Other regions

Source: Knight Frank Research, 2014

In the situation of market instability, major retail chains and distributors remain the main consumers of warehouse space



- Retail
- Distribution
- Transport and logistics
- Manufacturing
- Online retail
- Other

Source: Knight Frank Research, 2014

the 6-years record. About 63% of the total transactions volume were leased and purchased by end-users compared to 75% for the same period last year. St. Petersburg market accounted for about 8% of the total take-up, while in other major cities across the country the share of lease and purchase transactions amounted to about 29% of the total take-up – almost 150 thousand sq m. The take-up volume in regional cities is approximately 2 times higher than for the corresponding period in 2013. Yekaterinburg, Rostov-on-Don and Togliatti has totaled for almost a half of the total regional transactions volume (excluding the Moscow region, St. Petersburg and the Leningrad region). Thus, one can observe further growth of interest in the regional market of warehouse real estate.

In H1 2014, most of lease and purchase transactions on the market of the Moscow region were concluded for facilities located in the same areas where active construction of warehouses is underway. The largest take-up volume (approximately 44%) occurred in the Southeast (mostly along the Novoryazanskoe highway), whereas the Northern direction (between Leningrad and Dmitrov highway) accounts for the lease of about 27% of the total transactions in the Moscow region. As to the Southern directions (South and Southwest) about 50 thousand sq m, or 16%, of the total take-up were leased and purchased by end-users.

It is interesting to note that in H1 2014, 67% of the total transactions volume on the market of the Moscow region are constituted by purchase and lease of warehouse space by companies, which appeared on the Moscow market for the first time, or companies that already have storage space, but want to increase their market presence. A quarter of the total take-up consists of transactions by companies that have decided to relocate to other warehouses while also increasing the occupied space. The remaining 8% are transactions entered into by companies, which for various reasons have moved to other warehouses without increasing the occupied space.

In the situation of unstable market conditions, large retail chains and distributors constitute the main warehouse consumer base displacing small and medium businesses. Compared with small players, ma-

major warehouse consumers-players have access to a more affordable and sustainable financing. However, their decision-making regarding the lease and purchase of warehouses now lasts longer. Small and medium businesses are often forced to freeze development plans and engage in optimization of existing logistic processes.

By the end of H1 2014, the retailers and distributors of the Moscow region have purchased and leased about a half of the total volume of transactions concluded on the market, which is comparable to H1 2013. Logistics and transportation companies accounted for about 31%, industrial companies – for 7%, while 10% belong to other businesses, such as, for example, those providing document archival services. It should be noted that compared to H1 2013, when the share of online trading companies amounted to about 15%, in H1 2014, it dropped to 3%.

A third of the total transactions volume on the market of high-quality warehouse real estate in the Moscow region has fallen to four lease transactions of large blocks of 20 thousand sq m. Nine major lease and purchase transactions, which accounted for nearly 57% of the total transactions volume were signed in the same period last year.

Continued economic uncertainty increases the time it takes for the signing of purchase contracts for high-quality warehouse space: for the reported period, end-users acquired 1.9 times less space on the market of the Moscow region than for the same period the previous year. However, analysis of current buyer activity permits for a forecast of annual high-quality warehouse space purchase transactions volume in the Moscow region of at least 170 thousand sq m, which is comparable to the figure of 2011.

Commercial terms

Despite the fluctuations of exchange rate of the dollar against the ruble, the owners of warehouse facilities are not prepared to make considerable concessions and lower the sales prices: in H1 2014, the price of 1 sq m in high-quality Class A warehouses remained at \$ 1,200–1,400 (excluding VAT). This is largely due to the rising import costs of goods used for the construction

of facilities. However, full import substitution is impossible, because it will inevitably reduce the quality of the future building.

By the end of H1 2014, the average lease rate for Class A warehouse facilities settled at 120–130 \$/sq m/year (triple net – excluding operating expenses, utility bills and VAT).

Some differentiation of lease rates depending on the direction is noticeable. In the North of the Moscow region (between Leningradskoye and Dmitrovskoye highways, close to the A-107 “Betonka” highway) due to the high storage space construction volumes (about 30% of the total volume of new supply was delivered in H1, and about 300 thousand sq m more are expected by the end of the year) the lease rates may reach 120–125 \$/sq m/year (triple net). Meanwhile, practically no changes in the rental rates are seen in the Western and Southern directions. This situation results from a drop in vacancy rates in these areas of the Moscow region, as well as small (compared to the Northern and Southeastern directions) volume of new warehouse space in the current year. The number of leases, where the rate is denominated in rubles, is not growing because warehouses, as before, are mainly on credit in foreign currency. Furthermore, transition to ruble credits is also hindered by the unwillingness of tenants to accept indexation rate of ruble equal to Russian inflation.

Forecast

About 500 thousand sq m of high-quality warehouse space are expected to enter the market of the Moscow region in H2 2014. Considering the planned delivery volume, this year will set the record in terms of the new supply volume since 2008, and the total volume of high-quality modern warehouse space in the Moscow region will reach 9 million sq m.

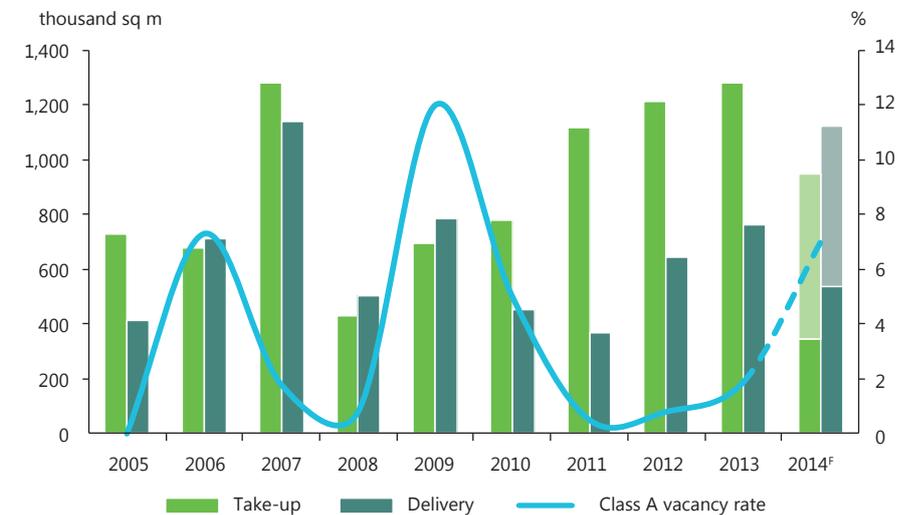
Due to the expectations of next wave of economic and political instability, potential tenants and buyers of high-quality warehouse space may adjust development plans, putting them on hold for until the market is stabilized. With this in mind, we expect the take-up volume on the Russian market in H2 2014 to total 700–800 thousand sq m. In this case, the total take-up of high-quality warehouse

Dynamics of average asking lease rates for warehouse space in the Moscow region



Source: Knight Frank Research, 2014

Take-up, delivery and vacancy rates dynamics for high-quality warehouse real estate market of the Moscow region



Source: Knight Frank Research, 2014

space on the Russian market for the current year may exceed the figure of 2010, however the figure is expected to be lower (down to 20%) than in 2011 and 2012.

By the end of 2014, the vacancy rate on the market of the Moscow region is likely to grow to a value of 7–8% due to the high

warehouse construction volume and the increase in purchase and lease contracts signing period.

By the end of the year, the lease rates in Class A warehouse facilities, in our opinion, will remain at 120–130 \$/sq m/year (triple net).

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