



RESEARCH



2015
**OFFICE MARKET
REPORT**
Moscow

HIGHLIGHTS

The volume of Class A and B office space delivered in 2015 fell by almost half comparable to 2014 and reached 721 thousand sq m.

The take-up volume amounted to 367 thousand sq m in 2015.

The rents denominated in Russian rubles dropped to 25,149 rub./sq m/year in Class A offices and to 15,103 rub./sq m/year in the offices of the class B category.



Konstantin Losiukov
Director, Office Department
Knight Frank

"The past 2015 was one of the most difficult years in the commercial real estate and office real estate, in particular, approaching and sometimes even below the historical minimum by some of the indicators. Most landlords adjusted to the descending market and offered favorable lease terms, while tenants took the advantage of the market situation to optimize their costs despite the difficulties and uncertainties. Several large transactions were completed as a result, thus slightly decreasing the vacancy rate.

It's evident that 2016 will be another challenging year for both tenants and landlords, and the results will largely depend on the ability of the parties to make concessions".

OFFICE MARKET REPORT MOSCOW

Key indicators. Dynamics*

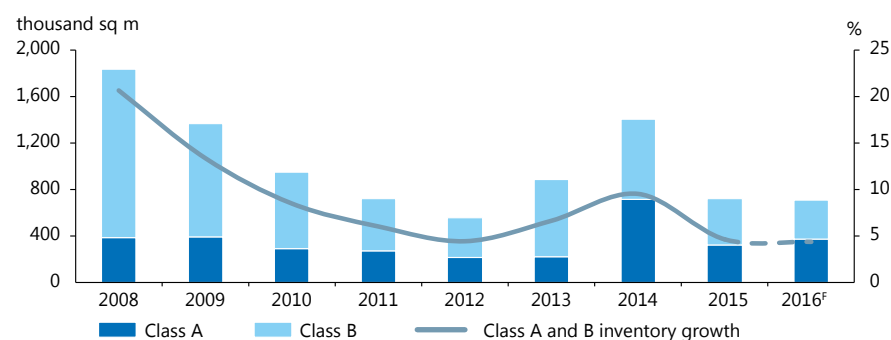
		Class A	Class B
Total stock, thousand sq m		15,484	
including, thousand sq m		3,716	11,768
Delivered in 2015, thousand sq m		721	
including, thousand sq m		327	394
Vacancy rate, %		24.4 (-5.2 p. p.)*	16.5 (+1.2 p. p.)*
Average weighted asking rental rate**	\$/sq m/year	474 (-19.7%)*	285 (-9.2%)*
	rub./sq m/year	25,149 (-16.6%)*	15,103 (-11.9%)*
Rental rates range**	\$/sq m/year	320–900	230–600
	rub./sq m/year	11,000–45,000	8,000–35,000
Average OPEX rate	rub./sq m/year	4,000–7,500	2,500–4,500

* Compared to Q4 2014

** Excluding operational expenses, utility bills and VAT (18%)

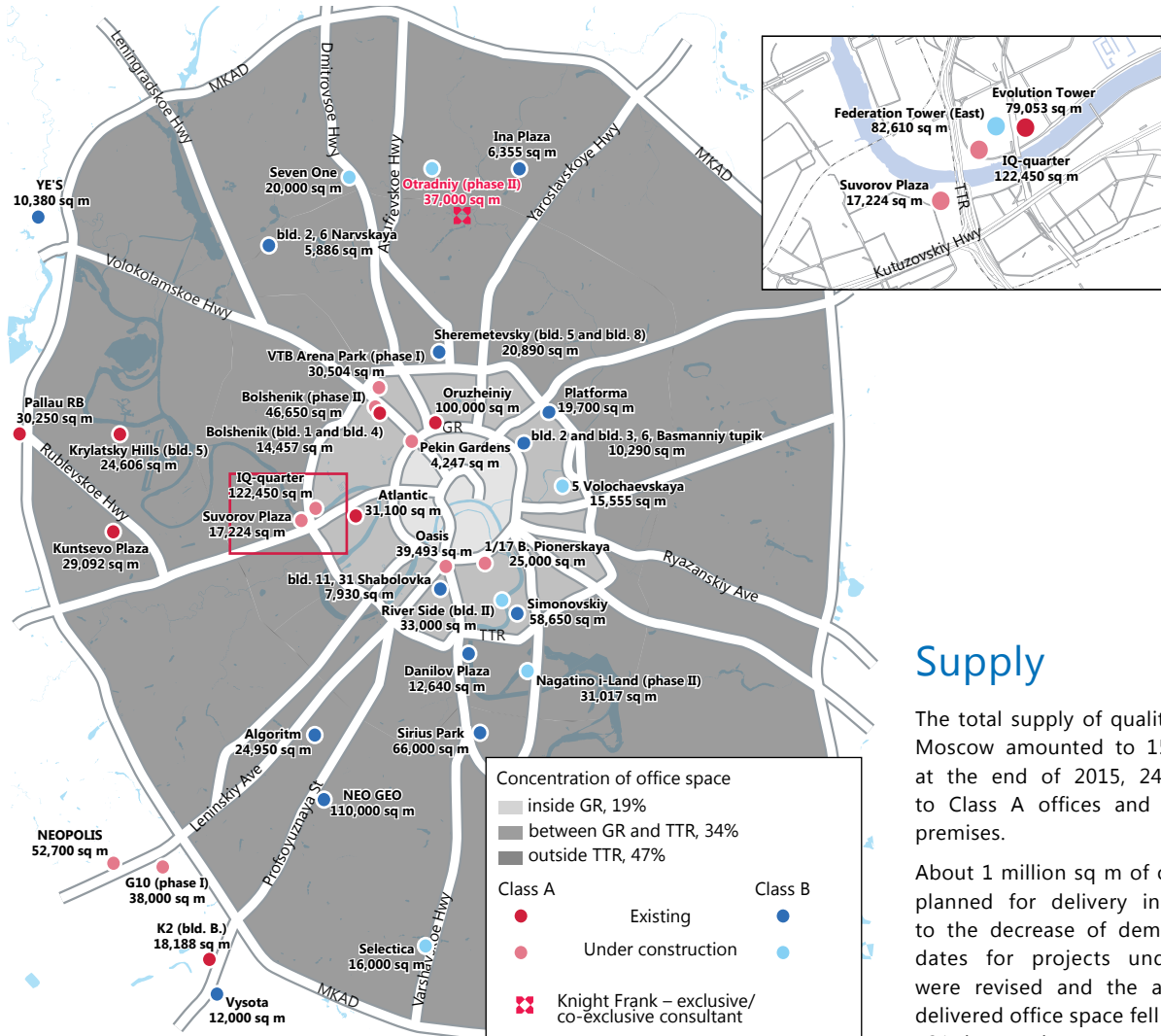
Source: Knight Frank Research, 2016

New delivery volume dynamics for Class A and B offices



Source: Knight Frank Research, 2016

Key office projects delivered in 2015* and due to be commissioned in 2016



Supply

The total supply of quality office space in Moscow amounted to 15.4 million sq m at the end of 2015, 24% corresponded to Class A offices and 76% to Class B premises.

About 1 million sq m of office space were planned for delivery in 2015, but due to the decrease of demand the delivery dates for projects under construction were revised and the actual volume of delivered office space fell by almost half to 721 thousand sq m.

In terms of Class A and B offices decentralization, caused by restrictions for commercial real-estate construction, only single office buildings, obtaining approval documentation before 2011 were delivered within Garden Ring.

The share of vacant space in Class A offices was 24.4%, which is 5.2 p. p. lower than last year. The decrease is due to the completion of a number of large transactions and transactions pending. The vacancy rate of Class B offices increased by 1.2 p. p. if compared with the previous year, this index was fluctuating within 1 p. p. during 2015, it was equal to 16.5% by the results of the year.

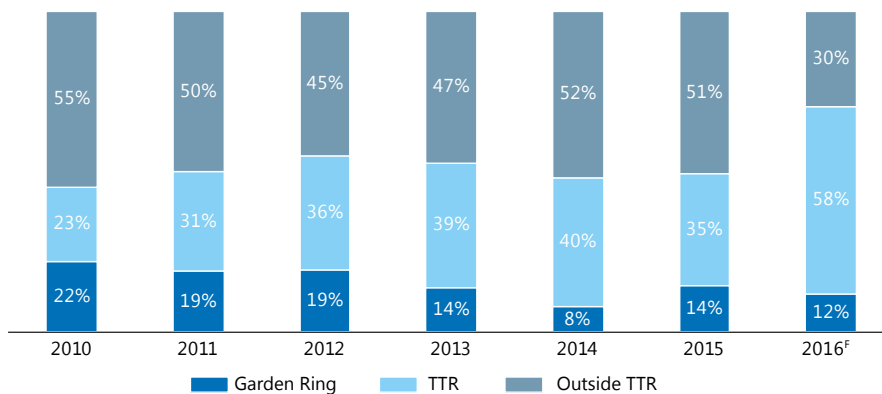
There are 3 million vacant sq m in existing quality office buildings according to the results of Q4 2015, more than 60% are in properties which were constructed in 2013–2014.

* Office properties that received the delivery act in 2015

The building class is indicated according to the Moscow Research Forum Office Classification of 2013

Source: Knight Frank Research, 2016

Class A and B office lease and sale transactions in terms of location



Source: Knight Frank Research, 2016

Demand

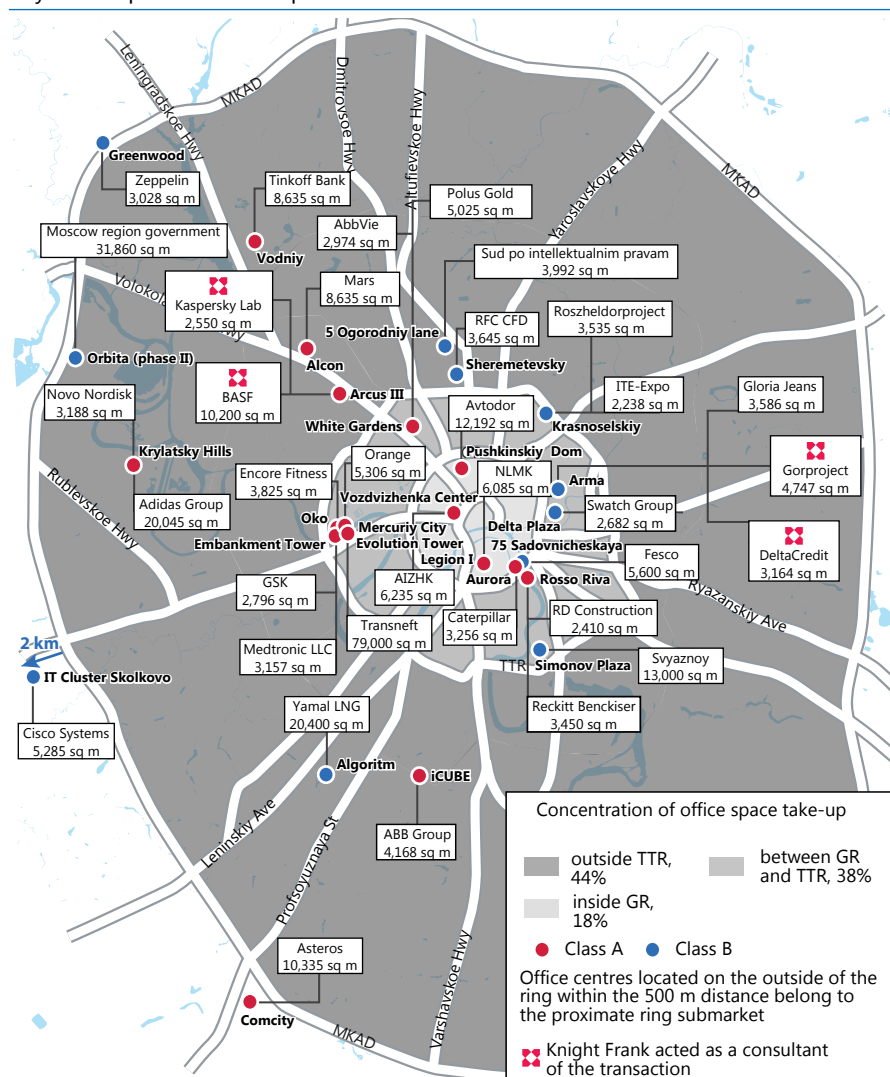
The take-up volume amounted to 367 thousand sq m in 2015, which is comparable to 2014 and 43% less than in 2013. It is worth noting that 20% of the take-up of 2015 refer to a single large transaction. Despite the preconditions for tenant activity reduction, there was considerable demand from tenants due to the desire to optimize their lease cost. Thus, renegotiation of lease terms amounted to 62% of total transactions in 2015.

Together with the revision of lease terms of current agreements, the companies were interested in the lease of new premises: the move to another office became attractive owing to reduction of asking rents for tenants, whose lease terms were close to their expiration. Today, the deferred demand is characteristic of the market when the companies witnessing the reduction of the average rental rates began to explore appropriate options for themselves.

Most companies while under negotiation process were willing to fix the current favorable lease terms for the maximum possible period in order to minimize risks. In turn, in long-term leases landlords exhibit less flexibility and insist on mandatory revision of the lease terms (often resorting to external consultants) or announce higher initial rental rates.

At the end of 2015 the average size of lease transactions amounted to 1,758 sq m, which exceeds the same indicator of previ-

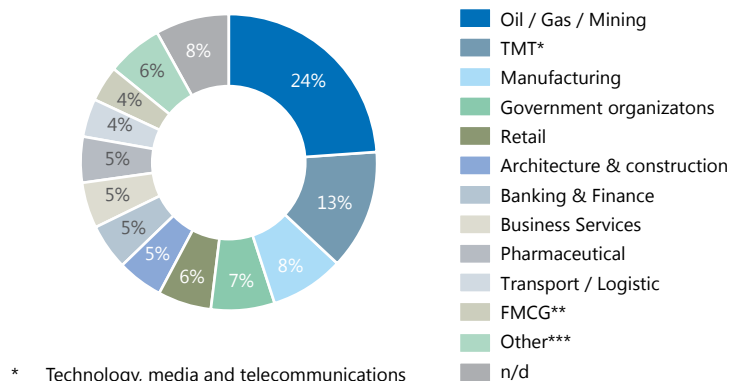
Key office space lease and purchase transactions closed in 2015



ous year by 16%. This evolution is due to the increasing number of large transactions against a decline in the total number of lease transactions on the market. For example, there were 8 transactions of more than 10 thousand sq m in 2015 to compare with 3 transactions in 2014.

At the end of 2015 the largest share in the total volume of demand fell to oil and gas companies due to two major transactions holding almost a quarter in the total volume of lease and purchase transactions. It is worth noting that the negotiation process of one of the transactions started in 2014 and continued throughout 2015. The companies of technology, media and telecommunications segment responsible for the stable share for several years concluded 13% of the total transactions in 2015. The share of companies of the financial and banking sectors, declining for the second year in a row, reached the minimum value in 2015, which is due to the negative dynamics of macroeconomic indicators and external constraints exerting a significant impact on the banking sector and the investment climate of the country. It should be noted that transport situation in the vicinity of the office became one of the most important parameters in structure of tenant requests influencing the decision to move. After another expansion of paid parking zone the companies are trying to provide as many parking spaces for its employees as possible on the territory of the office building.*

Tenant mix



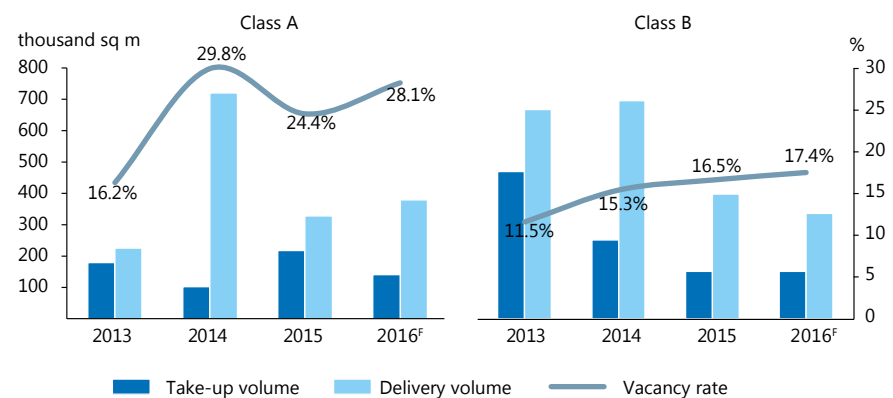
* Technology, media and telecommunications

** Fast moving consumer goods

*** Consumer services / Energy

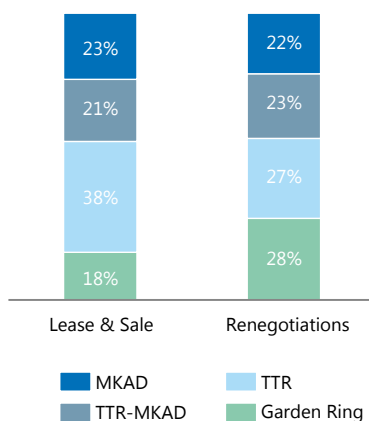
Source: Knight Frank Research, 2016

Dynamics of delivery, take-up and vacancy rates of Classes A and B offices



Source: Knight Frank Research, 2016

Distribution of deals by location



Source: Knight Frank Research, 2016



* Two individual zones of paid parking were organized throughout the year, as a result 386 streets in separate areas were included in paid parking system. Also, differential rate was introduced in a number of streets of the Boulevard Ring since August 10, 2015: the cost of the first parking hour is 80 rub./hour, and the second – 130 rub./hour. Further local expansion of paid parking zones in areas with complicated traffic situation is planned in 2016.

Commercial terms

Starting from 2013 the decline of the take-up volume against the backdrop of increasing amount of vacant space intensified the competition for tenants, which led to a decrease in asking rental rates. After reaching a ten-year low in 2014, the average asking rental rates demonstrated a further decline: by 20% in USD terms in Class A offices and by 17% in ruble terms, having fallen to historic minimum in 2015. The decrease in Class B offices was 9% and 12%, respectively.

The market of rental rates denominated in rubles continued to be formed in 2015.

By the end of the year a growing number of landlords began to express willingness to enter into long-term contracts denominated in rubles in contrast to the situation of H1 2015, when the conditions to fix the exchange rate or to include the currency band were available for the lease period of 1–2 years.

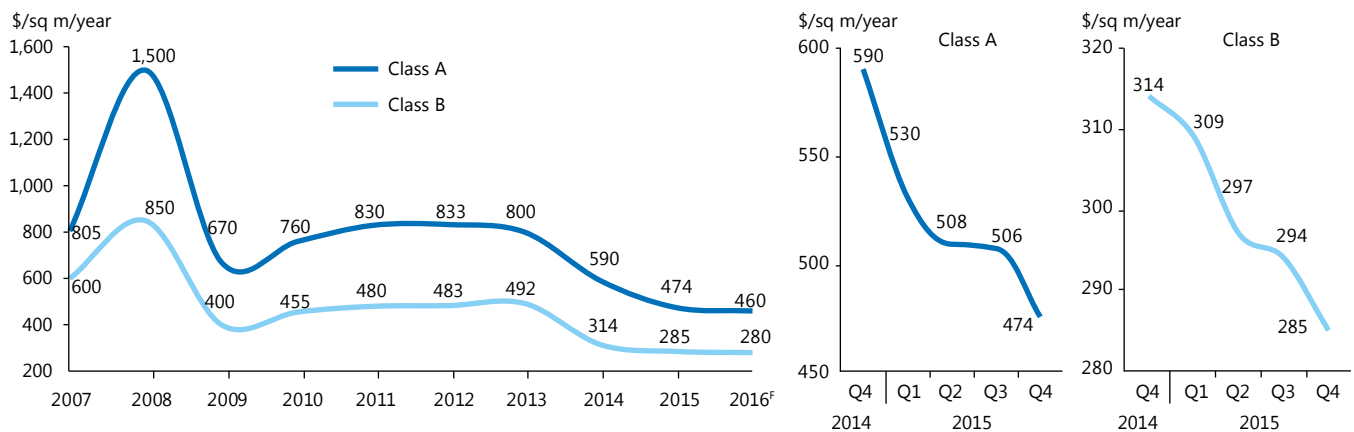
Forecast

According to our forecasts, in 2016 the volume of delivered quality office space will be at the level of 2015 and will be about 700 thousand sq m. Due to the large amount of vacant space as well as

limited access to debt financing, delivery dates for a number of office buildings were moved from 2015 to 2016. Therefore, such properties will amount for 63% of the volume of office buildings planned for delivery in 2016.

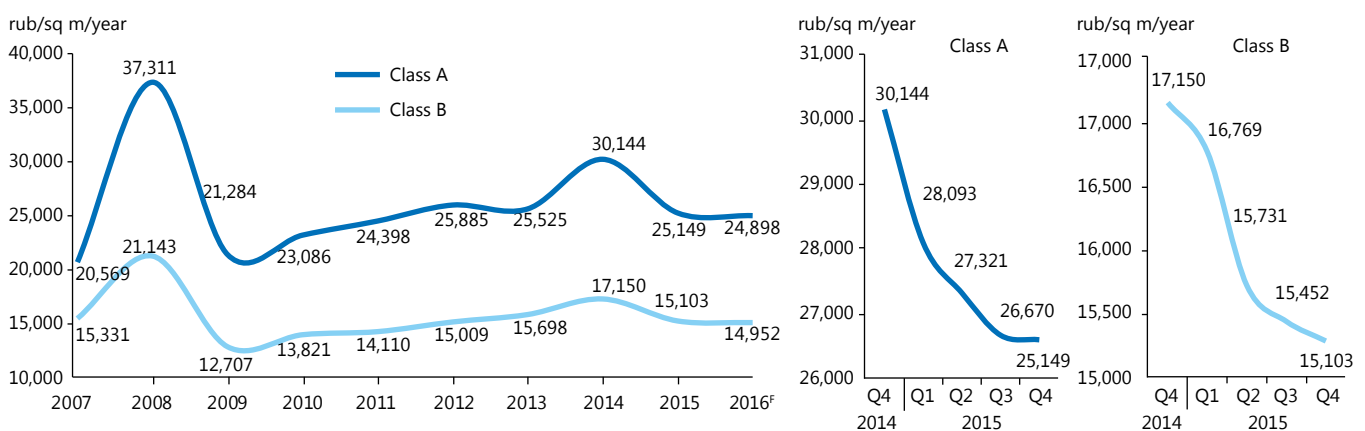
In 2015 the construction of earlier announced properties was postponed, and in some cases, developers have reduced or completely abandoned office component in their complexes under construction. The reduction of the number of projects under construction together with the take-up of office space in previously delivered properties will reduce the level of vacant space.

Average asking rental rates dynamics for Class A and B offices denominated in USD



Source: Knight Frank Research, 2016

Average asking rental rates dynamics for Class A and B offices denominated in RUB



Source: Knight Frank Research, 2016

Moscow submarket data. Key indicators

Submarket		Lease area, thousand sq m	Class A						Class B					
			Average rental rates				Vacancy rate, %		Average rental rates				Vacancy rate, %	
			\$/sq m/ year		rub./sq m/ year				\$/sq m/ year		rub./sq m/ year			
Boulevard Ring	Central business district	712	1,050		55,640		11.0		442		23,447		3.6	
Garden Ring	South	918	564	642	30,136	34,141	20.2	17.0	545	483	28,901	25,612	8.8	10.7
	West	273	842		44,623		13.3		514		27,261		13.1	
	North	660	805		42,663		7.0		–		29,565		12.8	
	East	401	–		23,666		25.8		347		18,392		10.1	
Third Transport Ring	Leninskiy	278	–	489	28,000	25,932	23.0	31.3	–	339	17,043	17,988	24.2	17.9
	Tulskiy	921	–		–		–		–		19,012		15.3	
	Khamovniki	260	810		42,920		20.8		–		29,439		4.7	
	Kievskiy	424	–		16,893		80.8		–		19,866		64.2	
	Presnenskiy	357	–		28,248		9.1		–		21,389		12.7	
	Prospekt Mira	162	–		20,417		28.4		–		20,536		22.3	
	Tverskoy-Novoslobodskiy	752	774		40,999		15.7		356		18,489		7.7	
	Basmanniy	532	–		–		–		–		17,188		16.9	
	Taganskiy	234	450		–		82.9		247		13,082		13.0	
	Volgogradskiy	432	–		30,000		48.0		299		15,860		15.1	
	MIBC Moscow-City	858	493		26,154		29.1		–		–		–	
TTR-MKAD	North	692	582	389	30,850	20,601	1.9	19.5	–	253	13,684	13,431	16.0	16.6
	South	1,706	358		18,967		45.1		–		12,332		18.8	
	West	1,144	548		29,020		14.4		–		18,986		16.4	
	East	658	–		13,155		38.4		–		11,340		15.3	
MKAD	North	525	–	294	–	15,596	–	32.46	–	192	8,463	10,201	13.7	18.8
	South	444	–		11,000		61.3		–		8,980		23.0	
	West	1,892	312		16,511		25.9		217		11,523		21.3	
	East	248	–		–		–		–		–		–	
Total		15,484	474		25,149		24.4		285		15,103		16.5	

Source: Knight Frank Research, 2016

Today, the office market offers the most attractive conditions for leasing and purchasing office space and large transactions can be closed, but the activity will continue to be limited in 2016 by a number of factors that determine the sentiment of the companies in 2015. In particular, plans for the development of both foreign and a number of Russian companies are hindered by the extension of sanctions restrictions until at least mid-2016.

According to the forecasts of macroeconomic development in Russia a serious deterioration of the economic situation will not occur in 2016. However, its improvement is not expected either. Since there is no justification of such expectations that the country's economy will experience a quick recovery like in the

crisis period of 2008–2009, the companies will continue to optimize costs adapting to the new realities.

We expect further development of the ruble market as a part of the commercial conditions in 2016. Rental rates denominated in a foreign currency will continue to decline, while the decrease of the rates in rubles will be slowing, and the adjustment of the index will depend on the change of the volume of office premises available at the market.

The share of transactions on the renegotiation of the lease terms prevailing in the total volume of transactions in 2015, could be reduced in 2016 and the main market activity will be driven by extension of lease agreements for the new term, as well as transactions on lease of new premises.

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