RESEARCH

H1 2015
RETAIL MARKET REPORT
Moscow

HIGHLIGHTS

H1 2015 has experienced the opening of six shopping malls with a total area of 778 thousand sq m (GLA – 316.4 thousand sq m). Facilities put on the market in Q1 2015 accounted for 75% of the new space added to the stock this year.

The total leasable area of quality shopping malls in Moscow reached 9.78 million sq m, while the total supply of rentable space exceeded 5 million sq m.

Operators remain focused on cutting expenditure or following short-term strategies.

Commercial terms in the retail property market are temporarily governed by supplements to the main lease contracts.

RETAIL MARKET REPORT MOSCOW

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"At first sight, the situation seems to be deteriorating: the volume of newly built supply is decreasing and the delivery of new space is being rescheduled to later in the year. Rental rates are continuing their fall along with the retail turnover closely followed by sales volumes of shopping mall tenants, and it's not yet clear when all the figures will stabilise.

On the other hand, all market players are adjusting to current realities and learning to listen to each other and work towards solutions together. All stakeholders – from banks to tenants – are interested in finding a compromise and no one wants to drown their partners, as obviously no relief would come but rather the problem would confront the aggressor. Market players are still in their search for the bottom without pushing the panic button but rather feeling reasonably confident about the possibility of working and growing even in a weak market."

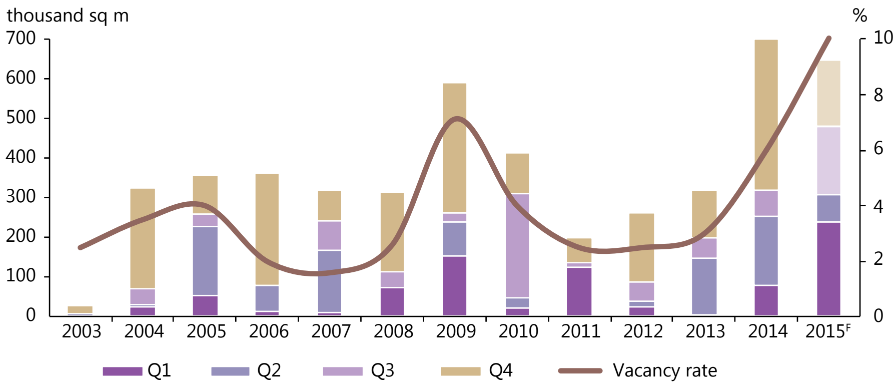
Key indicators*. Dynamics

Shopping centres stock (GBA/GLA), million sq m	9.78/5.06 ▲
Opened in Q1-Q2 2015 GBA/GLA), thousand sq m	778/316.4
Scheduled for opening in Q3-Q4 2015 (GBA/GLA), thousand sq m	540.5/339.2
Vacancy rate, %	9.1 ▲
Base rents, $/sq m/year (not including operating expenses and VAT)	
anchor tenants	100–400 ▼
retail gallery tenants	200–3,500 ▼
Operating expenses, $/sq m/year	80–260 ▶
GLA in quality shopping centres per 1,000 citizens	416.3 ▲

* The table refers only to high quality, professional retail properties. A professional shopping centre is a standalone building or a group of buildings sharing the same architectural style, concept and under common management, with a total area of more than 5,000 sq m

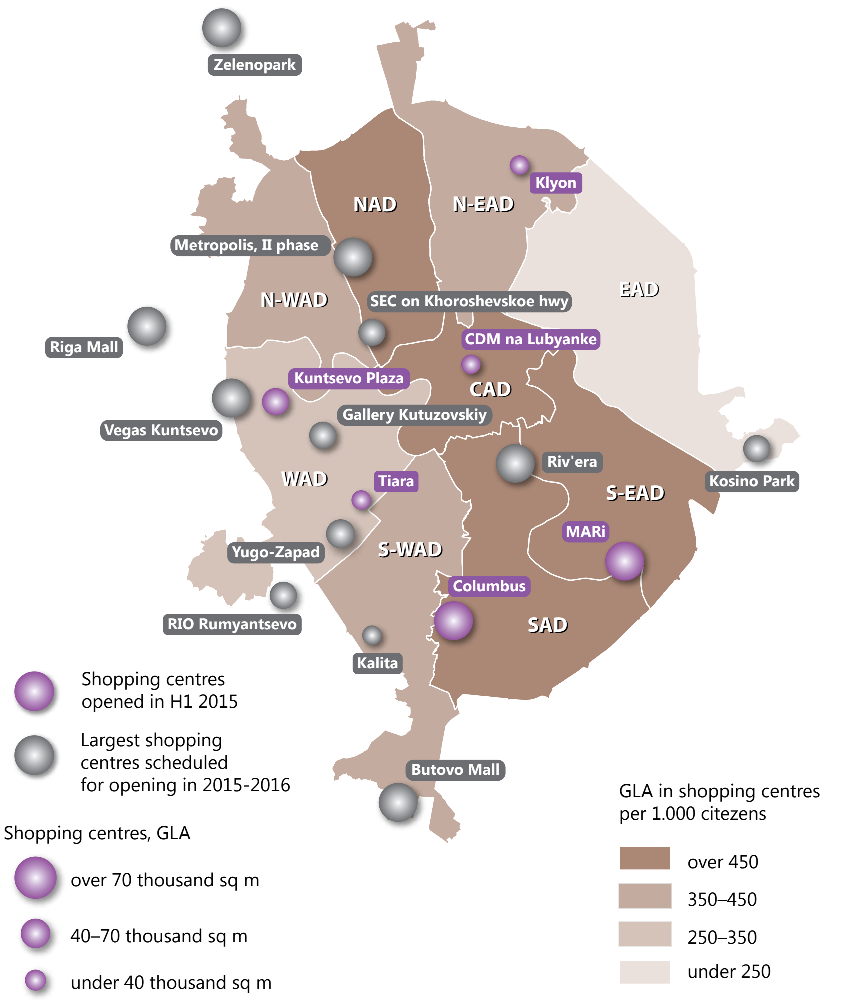
Source: Knight Frank Research, 2015

Volume of opened shopping centres and vacancy rate dynamic



Source: Knight Frank Research, 2015

Shopping centres opened in H1 2015. Largest shopping centres scheduled for opening in 2015-2016



Source: Knight Frank Research, 2015

Largest shopping centres opened in H1 2015

Object	Address	GBA, sq m	GLA, sq m	Developer
Q1				
Kuntsevo Plaza	19 Yartsevskaya St	245,000	65,000	Enka
Columbus	140 Varshavskoe Hwy	277,000	140,000	Mirs
CDM na Lubyanke	5 Teatralniy Passage	73,000	34,390	Hals-Development
Q2				
MARi	10 Porechnaya St	135,000	50,000	Lider
Klyon	11 Starovatutiskiy Passage	33,000	20,000	Capstroy
Tiara	27 Michurinskiy Hwy	15,000	7,000	Global

Source: Knight Frank Research, 2015

Supply

Six shopping malls with a total area of 778 thousand sq m (GLA – 316.4 thousand sq m) were opened in H1 2015. The market has beaten yet another record: for the first time in its modern history, the retail property segment increased by more than 300 thousand sq m already in the first six months of the year; and such supply levels are more typical for the second half of the year.

The delivered commercial facilities are not generally used to the full extent: some shopping malls after their launch has experience less than a 15% occupancy (or maximum 10% of leasable area). For this reason, delivered properties are still available for lease. By the end of H1 2015, the total available-for-lease space in operating shopping malls and facilities at different stages of construction amounted to 1.4 million sq m. Practice shows that this supply can be taken up within two to three years under favourable economic conditions.

MARI mixed-use complex has become the largest facility launched in Q2 2015 and will eventually include an entertainment and sports centre. Besides, two district level retail centres, Tiara and Klyon, were opened in Moscow's Western and North-Eastern Administrative Districts, respectively. In general, all shopping malls launched in 2015 (except for CDM na Lubyanke) and the assets slated for H2 2015 are far from the city centre.

Demand

Retail sales fell in January–May 2015 compared with the same period a year ago. The retail turnover in Russia dropped to 10,690.5 billion rubles, which is 92.3% of last year's level (in comparable prices). An adverse trend was also observed in the retail turnover structure: the share of food products reached 49.2% in January–May (a 2 p. p. rise year-on-year). The increased share of food products and the resulting smaller share of non-food products in the retail trades structure indicate that living standards are falling.

Positive trends include an increase in the consumer confidence index (reflecting consumer expectations) by 9 p. p. (–23%)

International retailers, opened its first store in Moscow in H1 2015

№	Brand	Country	Profile	Address
1	H&M Kid's	Sweden	Goods for children	CSDM on Lubyanka
2	Original Marines	Italy	Goods for children	Columbus
3	Silver Cross	Great Britain	Goods for children	CSDM on Lubyanka
4	Brums	Italy	Goods for children	CSDM on Lubyanka
5	Nelva	Belarus	Apparrel	AFIMALL City
6	Tsumori Chisato	Japan	Apparrel	Smolenskiy Passage
7	Maccheroni	Italy	Café/restaurant	Afimall city
8	The Bagel Bar	Irland	Café/restaurant	Street retail (75 Sadovnicheskaya Emb)
9	Greene King	Great Britain	Café/restaurant	Street retail (7 bld 1 Mytnaya St)
10	Heel'n'Tote	South Korea	Footwear	Lotte Plaza
11	Rocco P.	Italy	Footwear	GUM
12	Rouge Bunny Rouge	Great Britain	Cosmetics/Perfumeriy	Street retail (6 Barykovskiy Lane)
13	Serge Lutens	France	Cosmetics/Perfumeriy	Street retail (14a Neglinnaya St)

Source: Knight Frank Research, 2015

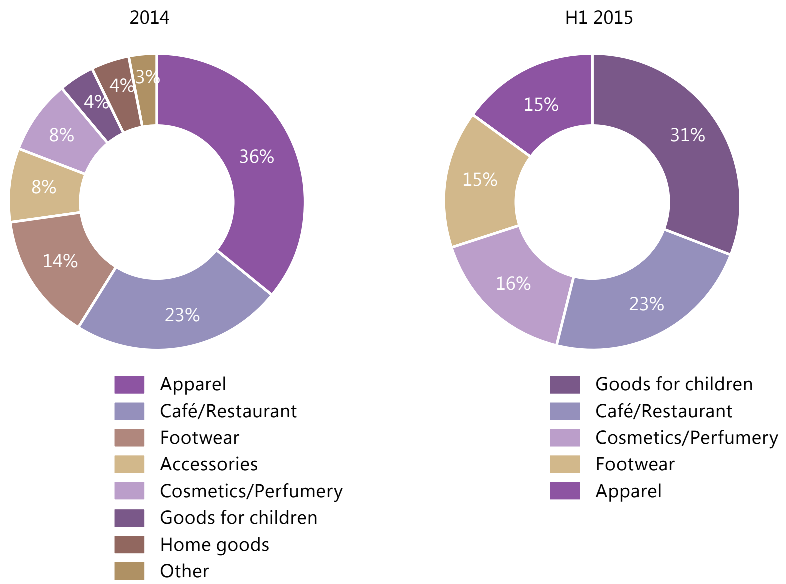
in Q2 2015, as compared with Q1 2015. The drop was partially offset by the strengthened ruble and adjustment to counter-sanctions; with its record low registered in Q1 2009 (–35%), the index however remains unstable.

The unfavourable macroeconomic and political environment forces many retailers to stick to cautious plans for their future in the Russian market. The first six months of 2015 witnessed low demand for commercial premises. The vacancy rate was growing as more half-empty shopping malls opened: the share of vacant space at operational retail assets in Moscow increased by 3.1 p. p. to 9.1% in the first half of the year.

Note that since the economic and political situation started to deteriorate, that is a year and a half ago, the vacancy rate has been growing by 1% quarterly on the average. At the same time, Knight Frank experts observe a varying vacancy rate at retail facilities with different launch dates. The vacancy rate for properties launched before 2013 amounts to about 6%, while at shopping malls opened in 2013–2014 every fifth square metre is vacant. At facilities launched in 2015 the vacancy rate can reach 70–80%.

In view of the current demand for commercial property from established players on the Moscow market, leasing campaigns are attracting more and more regional retailers looking to expand their

New international brands opened in Moscow by profile



Source: Knight Frank Research, 2015

chains, international players which have been developing primarily in the regional markets (Nevel, Brums, CAVIO), and brands that have not been opening new stores recently (for example, the second ON&ON store was opened four years after the first one; Nobu, a famous restaurant chain, opened its second restaurant – in Crocus City Mall – six years after entering the Moscow market; Eichholtz, a Dutch furniture company, opened its second monobrand store at AFIMALL City, etc.). Bringing less-known retail operators to Moscow's shopping malls is generally a positive trend since it helps diversify their tenant mix.

As to new international operators entering the market, 14 brands opened their stores in Russia in H1 2015. Some operators, such as German café chain OLIVA, French fashion brands Pimkie and SAINT JAMES, Italian children's clothes chain Original Marines started their way in Russia from cities other than Moscow. Thirteen operators (both new in Russia and those which expanded to the capital city's market from other regions) opened their flagship stores in Moscow. Among them are H&M Kids (Sweden, children's clothes), Maccheroni (Italy, restaurants), Serge Lutens (France, niche perfume), Tsumori Chisato (Japan, clothes), Silver Cross (Great Britain, nursery furniture and accessories) and others. It is worth noting that many operators still prefer street retail format for opening their first store in Russia. About 25% of international brands chose street retail to launch their brands in the country in 2014 and a third of new operators did so in H1 2015.

Several international brands have announced their plans to enter the Russian market with Superdry, Seiko, F&F and others among them. Currently, there are no factors that could boost global operators' interest in the Russian market.

Commercial terms

A distinctive feature of today's commercial property market is that participants are looking for new forms of cooperation. Entering into supplemental agreements, they continue revising and amending their long-term lease contracts signed before 2014: typically, landlords provide a discount off the dollar-denominated rental rate, or fix the contract's currency exchange rate, or link the rental payment to the turnover value.

As for the new lease contracts signed in 2014–2015, a rental paymant options linked to the tenant's turnover are typically set, as well as an advanced payment scheme. Every month tenants transfer a certain amount of money that counts towards future payments, which is based on preliminary sales figures and then adjusted according to actual performance. In case the advance payment exceeds the adjusted amount of rental payment, the difference is carried over to future periods.

It should also be noted that some lease contracts confer a right on a tenant to the out-of-court contract breaking option not resulting from a breach of obligations by the landlord. To this end, some owners are ready to agree on the tenant's unilateral exit from the contract without any penalties.

It is noteworthy that quality retail facilities have now tenants who prefer short-term lease contracts. These include various fashion designer associations interested in vacant premises fitted out by previous tenants. Such tenants do not spend a lot of money for the fit-out (as they prefer minimalist design) and accept the "rental rate = % of turnover" scheme only. Looking to reduce their vacancy rates and increase rental revenues, commercial property owners agree to lease out to more "experimental" fashion businesses.

No less important is the fact that some banking and investment organizations have started taking account of calculations based on potential tenants' turnover in feasibility studies of retail projects, which makes it much easier to defend them at the bank's credit committee and obtain the finance.

Rental rates denominated in foreign currencies have dropped 20–30% on average compared to early 2014. It is interesting that landlords now also consider ruble-denominated rental rates that include not just the base rate but also VAT and operating expenses.

Rental rates in modern shopping centres

Profile	Fixed rental rate, $/sq m/year		Indicator change in H1 2015	Share of rental payments in the turnover
	2014	H1 2015		
Hypermarket (>7,000 sq m)	100–250	100–250	0%	2–4%
Urban hypermarket (3,000–7,000 sq m)	200–350	150–350	0%	2–5%
Supermarket (1,500–3,000 sq m)	250–500	250–600	0%	5–7%
DIY (>5,000 sq m)	200–350	120–300	-5%	3–5%
White & Brown (1,500–3,000 sq m)	150–350	120–300	-10%	4–8%
Sporting goods (1,500–2,500 sq m)	150–300	100–300	-5%	12–14%
Goods for children (1,000–2,500 sq m)	200–400	150–350	-7%	8–12%
Apparel (50–300 sq m)	600–2,200	500–1,800	-10%	21–36%
Footwear (50–300 sq m)	900–2,500	500–2,000	-10%	25–30%
Accessories (10–70 sq m)	2,200–4,000	1,000–3,000	-20%	18–26%
Restaurants (500-1,000 sq m)	250–800	0–500	-15%	12–14%
Restaurants (250-500 sq m)	300–1,200	0–600	-12%	12–14%
Cafe/food-court (50-120 sq m)	1,500–2,300	1,100–2,000	-5%	12–18%
Cafe/food-court (120-180 sq m)	1,000–1,500	500–1 300	-8%	7–12%
Entertainment centres (200–1,500 sq m)	200–400	100–250	-5%	12–16%
Entertainment centres / Movie theatres (2,000–5,000 sq m)	100–200	0–150	-10%	8–14%

Source: Knight Frank Research, 2015

Largest shopping centres scheduled for opening in 2015

Object	Address	Total area, (GBA), sq m	Leasable area (GLA), sq m
Zelenopark	Leningradskoe Hwy, 17 km from MKAD	140,000	110,000
Kosino Park	Bld 5 Svyatoozerskaya St	90,000	39,000
RIO Rumyantsevo	Kievskoe Hwy, 1.5 km from MKAD	70,000	45,000
Yugo-Zapad	Intersection of Vernadskiy Ave and Pokryshkina St	70,000	40,000

Source: Knight Frank Research, 2015

Forecast

Based on the results of H1 2015, the projected newly built supply expected in Q3–Q4 2015 has been substantially revised: the delivery dates for five large shopping centres with a total leasable area of more than 350 thousand sq m have been pushed back to 2016. Thus, totally in line with the forecasts made by Knight Frank's experts, about 35% of commercial space initially slated for 2015 has been pushed back to later periods.

Nine shopping centers with a total area exceeding 540 thousand sq m (GLA – 339 thousand sq m) will open before the end of this year. These include such large shopping malls as Zelenopark (GLA – 110 thousand sq m), RIO Rumyantsevo (GLA – 45 thousand sq m), Kosino Park (GLA – 39 thousand sq m) and others.

In case shopping centres scheduled for opening in H2 2015 are 50% leased out, the average vacancy rate in the Moscow market will not exceed 12%. However, the situation may change if macroeconomic data deteriorates.

Shopping and entertainment center near the metro station "Polezhaevskaya"

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