CUSHMAN & WAKEFIELD | #MARKETBEAT

Q3 | 2019

Commercial Real Estate - Russia

#MARKETBEAT

Cushman & Wakefield Research Department

Oct'19

Macroreview

Capital Markets

Office

Retail

Warehouse & Industrial

Hospitality & Tourism

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Section 1

BACK IN THE USSR

In 2019 economy fell into stagnation. Previously Russia experienced volatile periods of ups and downs. In coming years we expect flat GDP, CPI and other indicators. However there will be significant structural changes with some industries underperforming and some demonstrating growth. The Government strategy is not aimed at growth of the economy as a whole, it is focused on correction of disparity and cash redistribution.

NEW CYCLE STARTS IN 2020

In 2019 transformation to the new era of stagnation 2.0 is finished. Slow growth, redundant regulation, permanent lawmaking and campaigns to stimulate development manually are the main characteristics of the new cycle.

In the third quarter most of the macro indicators for 2019 were decreased. Oxford Economics estimates GDP growth for 2019 at 1%. Consumer market is expected to grow by 1.7% on annual terms. As of August consumer market gained only 0.9%. Inflation appears to be a bit higher than it was expected – 4.7% on annual terms.

Food price increase drives consumer inflation. It means that severe cost cutting performed by producers and retailers in 2017-2018 has reached limits.

For retailers it means that from price competition they may have to compete by quality and services.

Office rents in Moscow lost about 1.4% in the third quarter, compared to the second quarter. However, leasing activity is very high: about 600 000 square meters of office space was transacted in Moscow in the third quarter.

The fourth quarter may be rather difficult for both: industry as a whole and some companies. Economy slowdown will affect day-to-day business. Performance may be lagging behind leading to cash gaps.

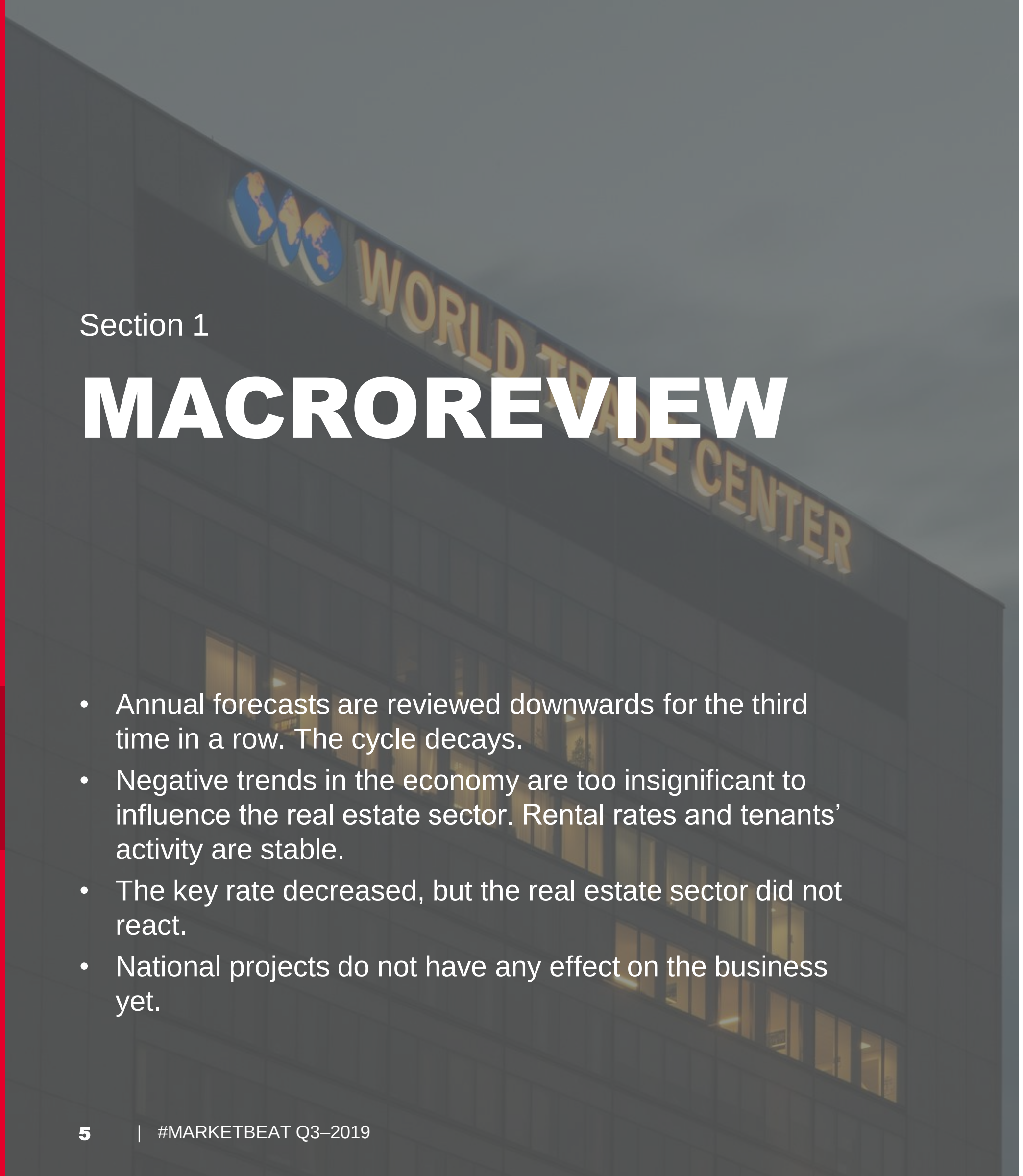
However, those who will manage to adjust to stagnation may be rather successful in 2020. Growth opportunities may be limited, but efficiency and competition positioning should be improved.

Private sector will compliment state and national projects and initiatives in many areas.

While the government entities became active market players there will be more deals driven less by economic and business rationale and more by bureaucratic considerations.

IMPORTANT

- WeWork – stress test for the segment.
- Inflation in the consumer sector speeds up.
- Purchasing power outflows to mortgage loans.
- Real disposable income decreases.



Section 1

MACROREVIEW

- Annual forecasts are reviewed downwards for the third time in a row. The cycle decays.
- Negative trends in the economy are too insignificant to influence the real estate sector. Rental rates and tenants' activity are stable.
- The key rate decreased, but the real estate sector did not react.
- National projects do not have any effect on the business yet.

MACRO INDICATORS

	2018	2019	2020	2021	2022
GDP growth, %	2.23	**0.9**	1.50	1.50	1.50
RUB/USD	62.67	**65.00**	65.00	63.40	62.40
CPI, %	2.88	**4.5**	3.7	4.1	4.0
GDP deflator,%	12.14	**8.88**	5.76	3.70	3.65
Interest rate, %	8.87	**9.05**	8.53	8.45	8.40
Current Balance, % of GDP	2.90	**2.2**	1.3	1.1	0.8
Private consumption, %	2.40	**1.70**	1.6	1.9	1.9
Government spending	0.29	**0.5**	1.1	0.7	0.6
Capital outflow, bn USD	-3	**-128**	-87	-75	-68
Unemployment rate, %	4.80	**4.8**	5.0	4.9	4.9
BRENT crude oil price	71.1	**64.8**	62.9	62.2	64.8

Source: Oxford Economics 10/10/2019

STAGNATION

Basic indicators do not change noticeably while macroeconomic forecasts are reviewed regularly. There is a consensus opinion of foreign and local experts for 2019, but the official forecast is much more optimistic about the coming years. However, there are no predictions that the national projects will stimulate the economy. More realistic forecast is stagnation at 0.5-1.5%.

1.3 %

GDP Growth for 2019

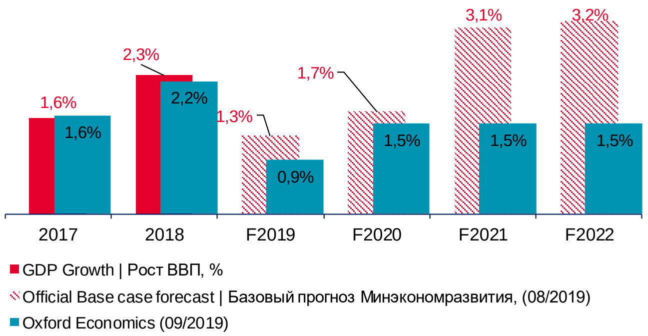
By the Ministry of Economic Development

3.8 %

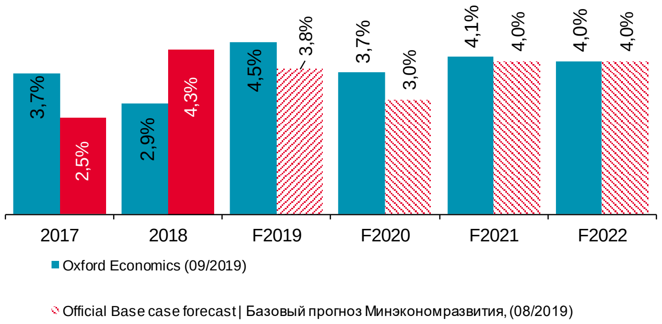
Inflation outlook for 2019

By the Ministry of Economic Development

GDP Growth, %



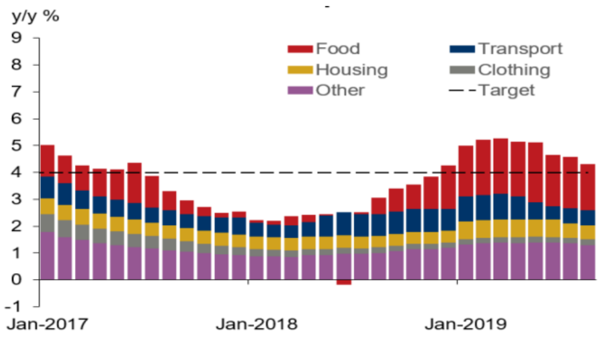
The Consumer Price Index, %



In 2019 food inflation is generated primarily by food products. Retailers will have to compete on quality and services, rather than prices.

Meanwhile, consumers are stuck between stagnating income and accumulated household debt.

Inflation



Source : Oxford Economics/Haver Analytics

2017-2023 – PERIOD OF EXPENSIVE MONEY

Real estate market stagnation

The difference between the lending rate and inflation is used to indicate the real cost of money.

Since 2017, a period of expensive money and low economic growth has begun.

This has resulted in the emergence of concessional financing for priority projects, since commercial rates will be available only for high margin projects.

Foreign capital, which in the era of the economic boom provided an inflow of cheap loans, is not available now. Competition in the financial market will continue decreasing.

THE CREDIT BOOM CONTINUES

After a slight decline in July, mortgage debt increased by 1.5% in August. Advanced payments dynamics slowed down – 8% in Jan-July 2018 and 6% in Jan-July 2019. Credit burden on households grows faster.

6 %

Of mortgage debt was paid ahead of the term

In H1 2019

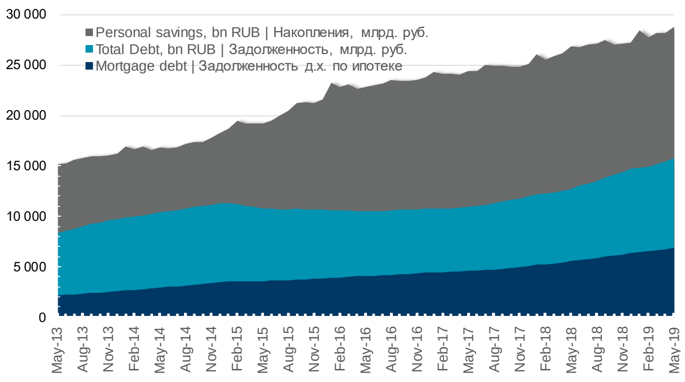
6 %

Share in GDP

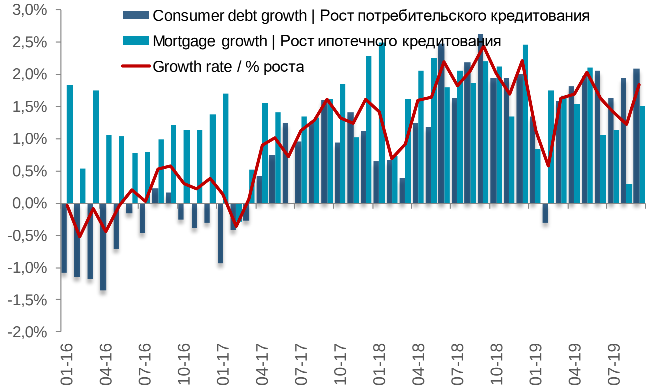
Of the mortgage debt in Russia

Source: the Central Bank, Cushman & Wakefield calculations

Shares and deposits (of physical persons), bn RUB



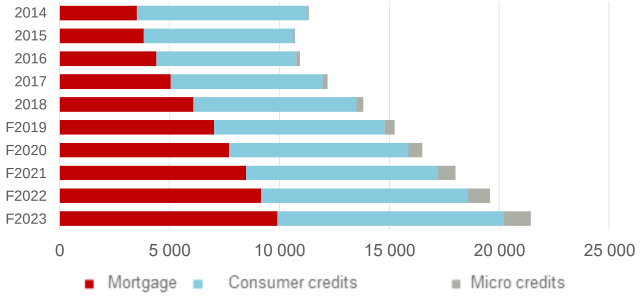
Growth rate of household debt



Mortgage debt is growing and households have less money to spend in stores. While this provides stable revenue stream for banking sector, the consumer market remains under pressure.

We do not expect revitalization of consumption in coming years.

Household debt structure, bn RUB



CREDIT FREEZE

In 2019, the growth of corporate debt ceased, primarily due to the reduction of foreign currency debt. The revival of the real sector is not expected this year.

7.0 %

Key Rate

Increased by 0,25 in September 2018

21 %

Overdue Debt

In Real Estate sector

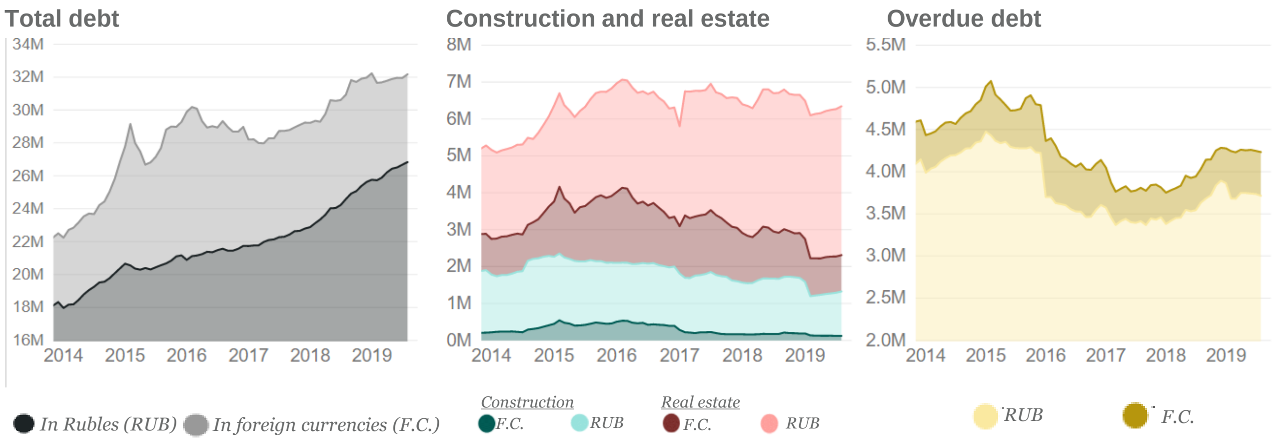
Power BI

Source: The Central Bank of Russia

Construction and real estate are still in the credit compression stage. The transition of housing construction to project financing may spur the growth of the credit market in construction, but this will occur gradually, and most likely we will not see the effect until 2020.

Debt growth in the wholesale and retail trade has stopped. The retail market is trapped between declining household incomes on one hand, and rising costs, on the other. In this situation, the industry has switched to austerity mode, thus reducing storage stocks and cheapening the assortment.

Corporate debt and overdue debt, mn RUB



Section 2

CAPITAL MARKETS

- Investment market shows first signs of revival.
- The Russian market is now more oriented on internal investments.
- Capitalization rates do not react on key rate decrease.
- Capitalization rates for non-prime buildings may exceed 14%.
- Foreign investments outflow is finished.

1.71 bn EUR

Total investment volume in Russia

In Q1-3 2019

2.5 bn EUR

Total investment volume in Russia

Forecast for 2019

9.5 %

Capitalization rate, prime office segment

October 2019

67 mn EUR

Net outflow of foreign investment in Q1-3 2019

EASTERN EUROPE: THE MARKET IS RECOVERING

In 2019 investments in Central and Eastern Europe will exceed last year's indicator.

+50%

Investment in Russia

Q1-3 2019 compared to Q1-3 2018

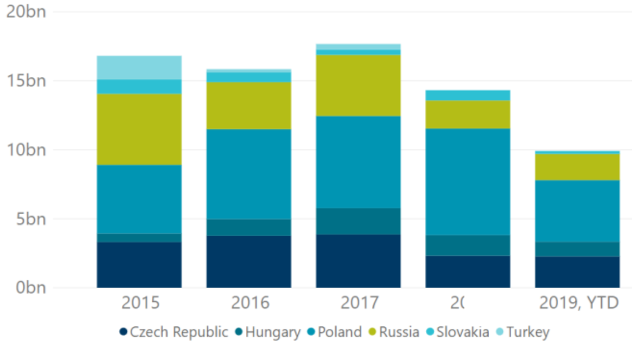
4.5 bn EUR

Investment volume in Poland in 2019

The largest investment market in CEE region since 2016

Source: Real Capital Analytics

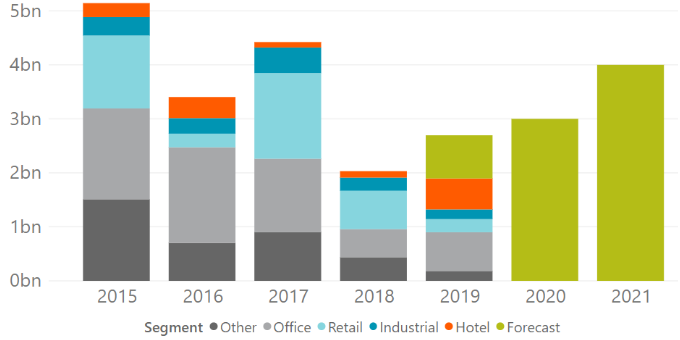
Investments in the core CEE markets, bn EUR



Three quarters of 2019 brought 1.7 bn Euro of investments into commercial real estate. It is 50% more than from the same period of 2018. However it is still very small amount for the Russian market, which is capable to absorb about 10 bn Euro annually.

Poland is the leading investment market in the CEE region with annual figure of about 6 bn Euro.

Investments in Russia, bn EUR



By the end of 2019 we expect investment volume to reach 2.5 bn Euro. In 2020 growth will continue and investments will reach 3 bn Euro. In 2018 market reached its lowest point and since then landlords, investors and developers have adapted to new pricing.

Net outflow of the foreign capital is low, only 67 million Euro left Russia in 9 months.

Capital Markets

CAPITALIZATION RATES

9.5 %

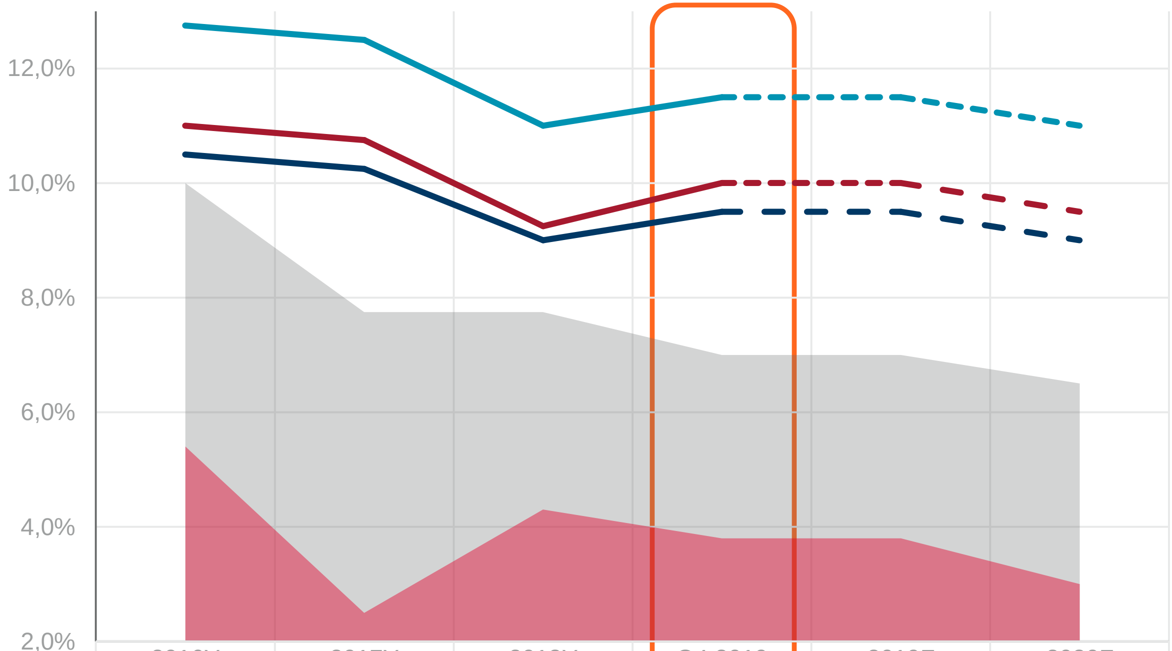
Office

Capitalization rate

7.0 %

The key rate

The Central Bank of Russia



	2016Y	2017Y	2018Y	Q4 2019	2019F	2020F
Central Bank Key Rate	10,00%	7,75%	7,75%	7,00%	7,00%	6,50%
Inflation	5,40%	2,50%	4,30%	3,80%	3,80%	3,00%
Office	10,50%	10,25%	9,00%	9,50%	9,50%	9,00%
Shopping Centers	11,00%	10,75%	9,25%	10,00%	10,00%	9,50%
Warehouse	12,75%	12,50%	11,00%	11,50%	11,50%	11,00%

Section 2

OFFICES

- All market indicators are balanced.
- Demand for office premises keeps record high level of 2018. In the coming years, a significant decrease in take-up is not expected.
- Against the backdrop of high demand, construction activity has increased. In 2019, new construction will exceed the last year's anti-record by three times.

Moscow Q1-3 2019

Classes A, B+ & B-

17.89 mn sq. m

Total stock of office buildings

227 ‘000 sq. m

Construction

1.92 mn sq. m (10.8%)

Vacancy

1.56 mn sq. m

Take-up

Offices

TENANTS HAVE TO PAY PREMIUM FOR LARGE CONSOLIDATED OFFICE BLOCKS

Tenants become less sensitive to higher rental rates against a lack of large quality blocks in business centers of Class A.

NEW SUPPLY

2019 opens a new stage of office real estate development with a stable level of new construction. In the coming years, new construction will remain in the range of 300,000-400,000 sq. m annually.

227

'000 sq. m

New construction

In Q1-3 2019

400

'000 sq. m

New construction

In 2019F

Source: Cushman & Wakefield

Construction volume in Q3 is comparable to the total of H1 2019 (107,000 sq. m).

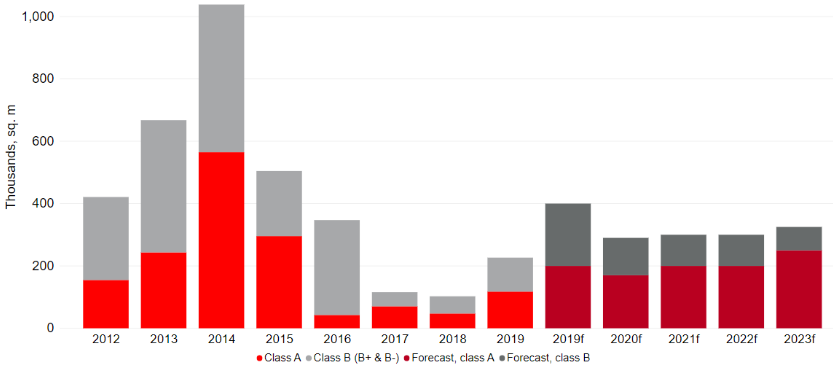
Five office buildings were delivered into the market, four of which have rentable area more than 10,000 sq. m (Novy Balchug, Academic, OKO II, Vereyskaya Plaza IV). The need to build new high-quality properties resulted from large tenants' demand. 60% of new office premises in 2019 were pre-leased before completion of the building.

In 2019, new construction will be more than three times larger compared to the 15-year anti-record last year. Developers increase the pace of construction against stably high demand and a lack of large quality blocks.

Through 2019 – 2021, 0.9 – 1 mn sq. m of new office space will be delivered into the market, 600,000 sq. m of which will be class A.

New office properties are located in different parts of the city within the Moscow Ring Road.

New construction, class A and B



DEMAND

The expected decline after records of 2018 has not occurred. Take-up in 2019 will remain at the level of 2018 and will be about 2 mn sq. m. The share of sale deals is growing, mainly in the banking sector.

1.56

mn sq. m

Take-up (lease and sale deals)

In Q1-3 2019

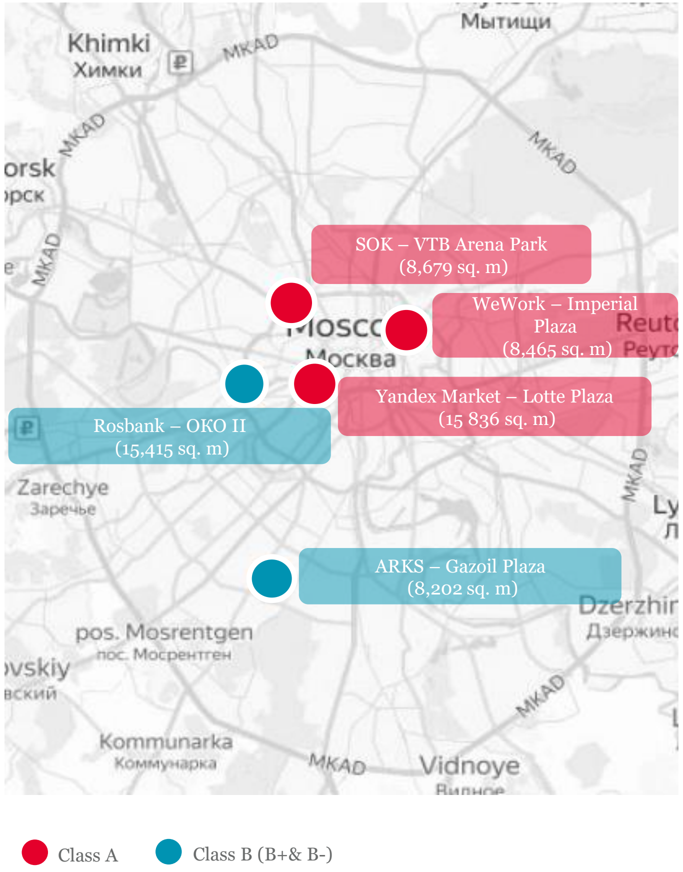
2 mn sq. m

Take-up (lease and sale deals)

2019F

Source: Cushman & Wakefield

Major deals in Q1-3 2019



In Q1-3, demand for office space exceeded the record high of 2018. The share of pre-lease deals is growing due to the lack of quality office space (Q1-3 2018 - 0.3%, Q1-3 2019 - 5.3%).

Demand for the purchase of premises is growing, the share of sale deals increased by 2.5 times compared to the previous year (Q1-3 2018 - 8.7%, Q1-3 2019 - 22%). In Q3, five of the Top-10 largest deals in Moscow are sale transactions. 76% of sale deals were closed by banks. Against the background of cheap money and reduced interest rates on deposits, banks have few investment options as the economy is stagnating. Thus, banks prefer buying real estate on the low market, rather than paying lease.

Against the backdrop of high demand and limited supply of large office blocks (more than 15,000 sq. m) competition is increasing. If tenants are interested in a large area in a quality building, they have to pay premium.

VACANT OFFICE PREMISES

Despite the increased new construction, healthy demand holds the vacancy rate at 11%.

10.8 %

Vacancy rate in Q1-3 2019

Classes A and B (B+ & B-)

1.92 mn sq. m

Vacant premises in Q1-3 2019

Classes A and B (B+ & B-)

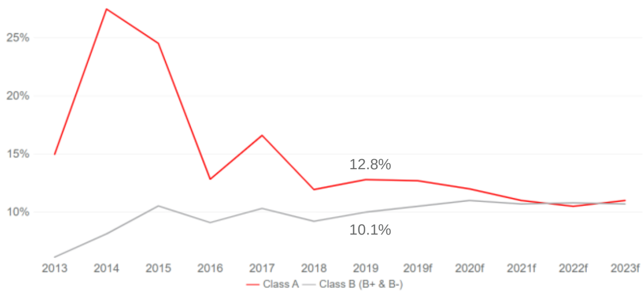
744 '000 sq. m

Vacant premises with exposition period more than 1 year

Classes A and B (B+ & B-)

Source: Cushman & Wakefield

Vacancy rates

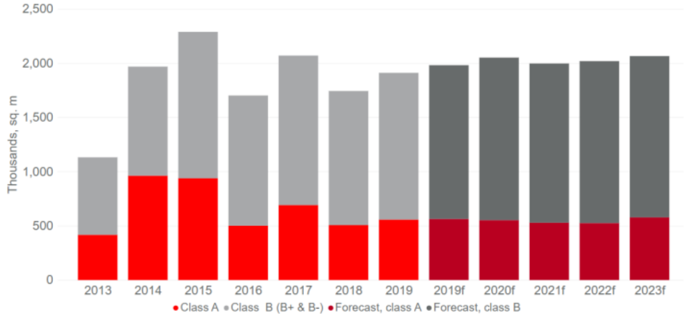


At the end of Q3 2019, the vacancy rate amounts to 10.8% (class A - 12.8%, class B - 10.1%), which is 0.9 p.p. higher than at the end of 2018 (9.9%). The increase in vacancy is caused by increase of new construction.

In general, the vacancy rate remains stable during the year. At the same time, vacancy is decreasing in the central areas, where new construction is limited and slightly growing outside the center, where construction activity is concentrated.

We expect demand to remain high in 2019, which will keep the vacancy at 11%.

Vacant premises



The total figure of vacant premises is about 2 mn sq. m, 40% (744,000 sq. m) of which have been marketed for more than 1 year. Considering high activity of tenants these are most likely obsolete premises.

The Center and West remain most popular when choosing an office. The largest number of deals was closed in these business areas. The main demand for Class A is traditionally in buildings within the Garden Ring.

ABSORPTION

By the end of Q3 2019 absorption reached positive zone. Despite the fact that new construction increased compared to the previous periods, absorption is in the positive zone due to stable demand.

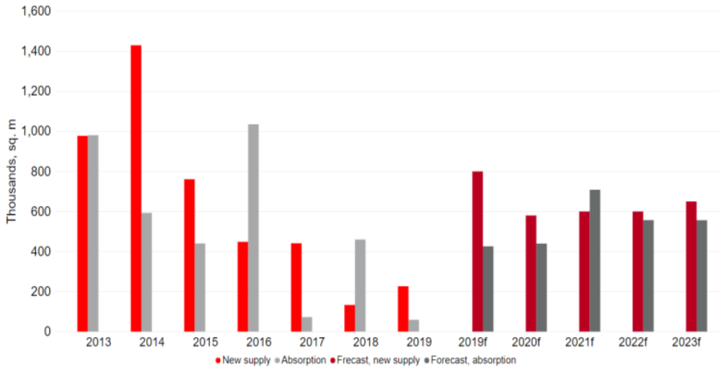
In the coming years, we expect that absorption will be about 200,000 - 300,000 sq. m annually.

52

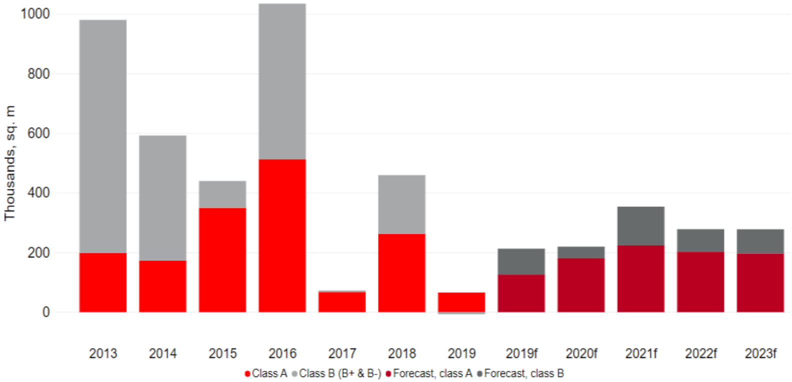
‘000 sq. m

Absorption in Q1-3 2019

Absorption and new construction



Absorption by class

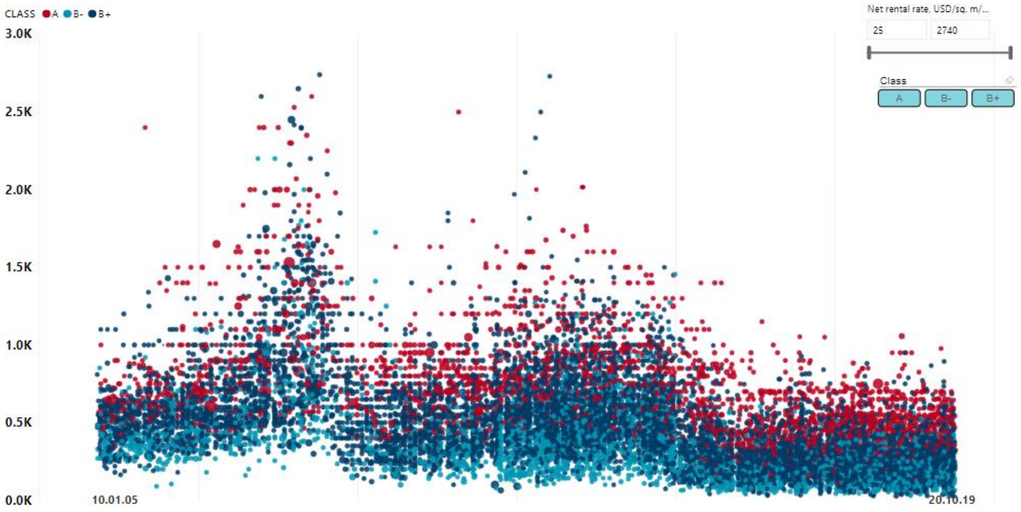


Absorption is an indicator that reflects the difference between the area occupied at the beginning and at the end of the period. *Positive absorption* means that additional vacant office premises are “absorbed" from the market. *Negative absorption* reflects the opposite - release of additional office space, which together with new construction leads to vacancy.

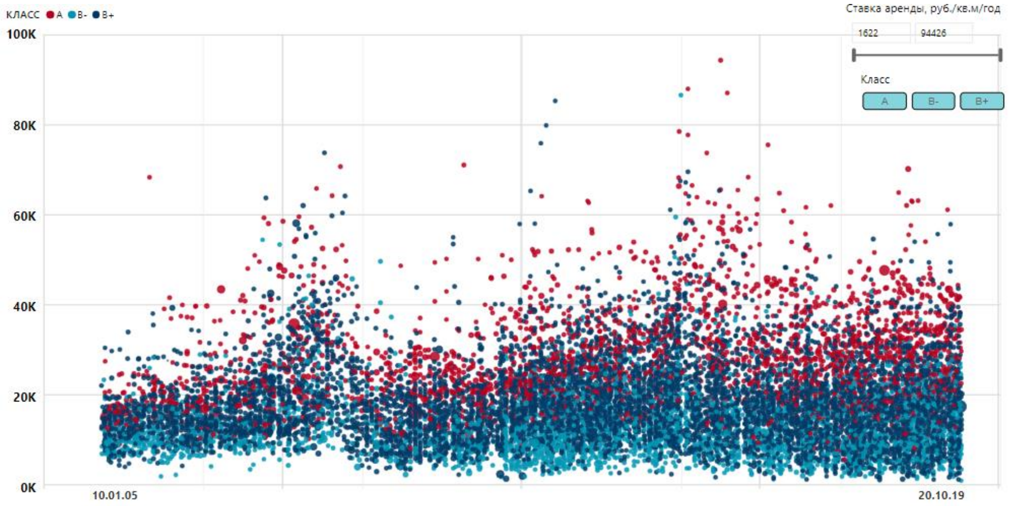
Source: Cushman & Wakefield

LEASE DEALS IN MOSCOW

Rental rates in USD equivalent



Rental rates in RUB equivalent



- The dots on the chart are office lease deals. The horizontal axis represents the date of the deal, and the vertical axis shows the rental rate in USD or RUB equivalent.
- Using the link or QR code, you can access an interactive graphic that displays the details of each transaction.

Use this link to access an interactive graphic

RENTAL RATES

Rental rates increased compared to the end of 2018. Growth was affected by the rise in class B, starting from the end of 2018. By the end of the year, rental rates in Class A will increase.

305

USD / sq. m annum

January - October 2019

US Dollar equivalent (all deals in classes A and B)

19,805

RUB / sq. m annum

January - October 2019

Ruble equivalent (all deals in classes A and B)

Source: Cushman & Wakefield

Leasing demand and rental rates, January - October 2019

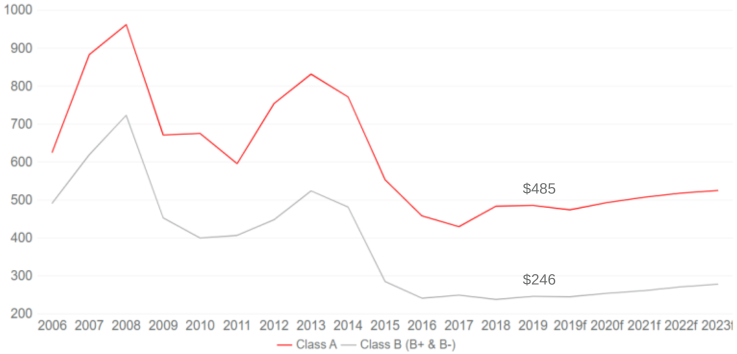
Class	Deal currency	Deals volume, sq. m	Rate
A	USD	132,108	$591
	RUB	251,496	24,787 RUB
B+ & B-	USD	55,650	$479
	RUB	1,222,238	15,787 RUB

According to the results of Q1-3, rental rates increased by 2.9% compared to the indicator of 2018.

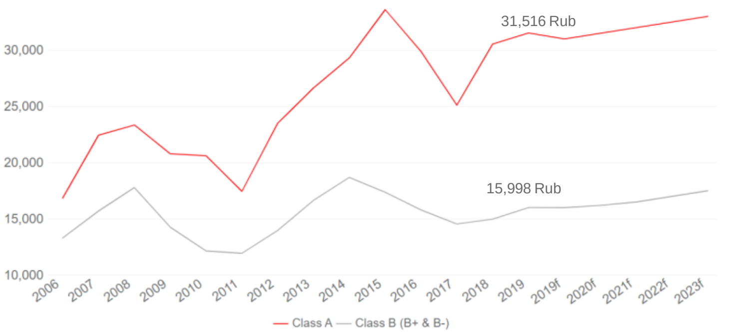
The average US Dollar equivalent of rental rates in Class A (October 2019) is 485 USD/ sq. m/year (31,516 Rubles/ sq. m/year). The average US Dollar equivalent of rental rates in Class B is 15,998 Rubles/ sq. m/year (246 USD/ sq. m/year).

In the coming years the average rental rate will continue to grow by 4-6% per year.

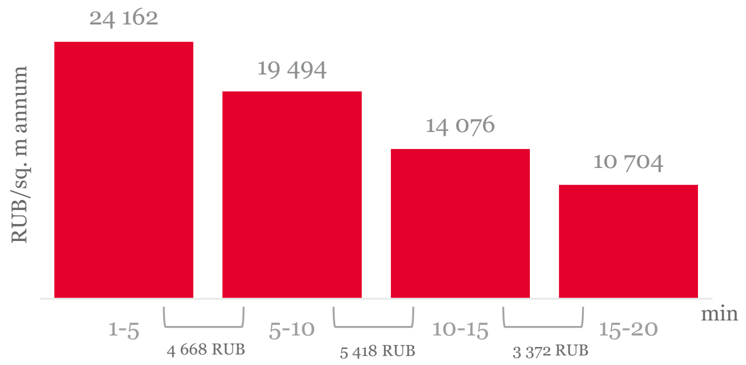
Rental rates in US Dollars



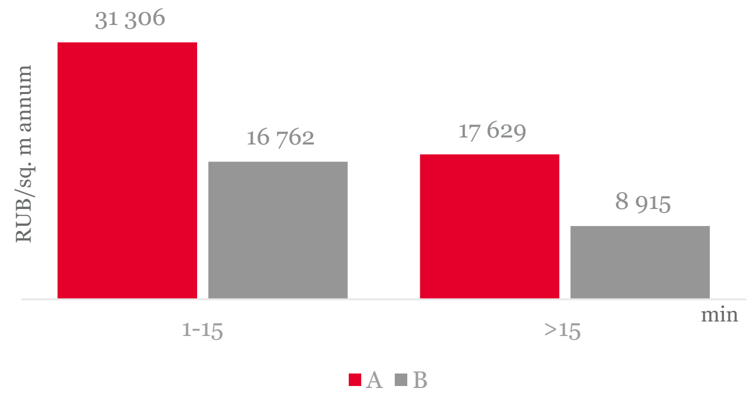
Rental rates in Russian Rubles



The dependence of rental rates on walking distance from metro



The gap in rental rates depending on metro distance (by walk)



THE RELATION BETWEEN RENTAL RATES AND METRO DISTANCE

24% is the average drop in rental rates every 5 minutes by walk. Rental rates in buildings located close to metro are almost 2 times higher than in remote areas.

There is a set of factors, which includes building remoteness from metro station, that has an impact on rental rate. The analysis of the average rental rates showed that rental rate decreases by 24% (4 500 RUB) every 5 minutes by walk.

Rental rates in buildings located close to metro are almost 2 times higher than in remote areas. It is more profitable to build properties of class A near the metro, since their rental rates will be much higher than in class B.

90% of office premises of class A are located closer than 15 minutes from the metro. The remaining 10% incurs additional costs for arranging the shuttle bus. In such buildings, rental rates are lower than in comparable properties with higher accessibility.

The full version of the report ‘Every minute counts: the relation of rental rates on metro distance’ is available at www.cwrussia.ru

Section 2

RETAIL

- Against the background of market stagnation and decrease of real disposable income, retail turnover growth will be limited.
- Construction activity in Russia remains stable. In 2019, the largest share of new retail space will be concentrated in the Moscow area.
- Vacancy rate in Moscow is gradually decreasing. However, by the end of the year the indicator may show a slight growth due to the opening of two large retail schemes.
- Average rental rate remains stable, prime segment shows moderate growth.

5.3 mn sq. m

Total quality stock in Moscow

In quality shopping centers, mixed-use buildings, outlets, and retail parks

300 ‘000 sq. m

New construction, Moscow, 2019F

Retail properties with GLA of more than 15,000 sq. m

7.7 %

Vacancy rate

Quality shopping centers, Moscow

170 ‘000 RUB / sq. m

Prime rental rate indicator

Base asking rental rate for a 100 sq. m gallery unit on the ground floor of a prime shopping center

PREDICTED DROP

As expected, this year is difficult for the consumer market. Due to the high loan debt, income is still not growing, which will lead to the further shrinkage of consumption next year.

1.5%

Retail sales growth

Jan-Aug 2019 compared to Jan-Aug 2018

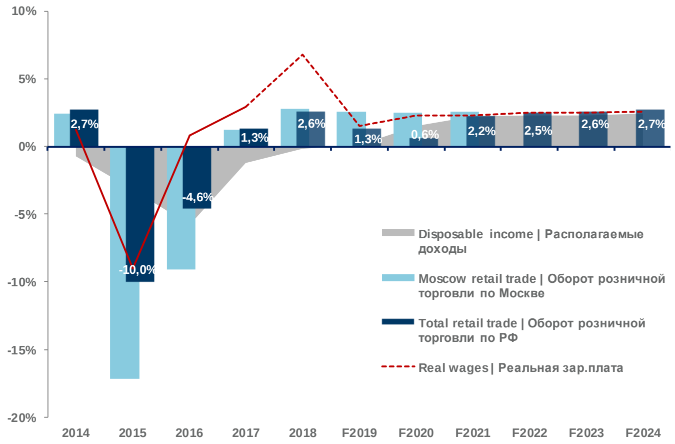
-1.3%

Real disposable income growth

Jan-Aug 2019 compared to Jan-Aug 2018

Source: The Ministry of Economic Development, August 2019, Rosstat

Consumer Market



The official forecast for retail sales was revised significantly. This year the growth will slightly exceed 1%, but next year will be two time lower (1.3% and 0.6% respectively). The long-term forecast of the Ministry of Economic Development has not yet been changed, however it seems to be also revised downward later. Against the background of the economy stagnation the retail sales growth is not likely to exceed 2% in the mid-term perspective.

Real disposable income remains in negative zone, but the gap with the last year is narrowing. So the official forecast (0,1%) looks realistic.

Population has limited financial resources, which once again supports the point about the market stagnation.

“RETAIL THERAPY”

Generation Z cares about their health, especially mental health, and is more stress-sensitive than previous generations. This emotional fragility affects their shopping patterns.

81%

Of Generation Z consumers*

Prefer offline shopping

58%

Of Generation Z consumers*

Offline shopping allows them to escape from the digital world (social networks and media)

Source: Future Consumer Report, A.T. Kearney, June 2019

*The survey polled 1,500 US and Canadian consumers – representing four generations of shoppers.

Even though the Generation Z (Homelanders) grew up in a digital era, according to the survey they prefer offline stores at all the stages of shopping – searching for products, trial, purchase (73%, 65%, 81% of respondents, respectively).

High emotional fragility of this generation makes them very sensitive to the negative experience, both while shopping online and offline. Homelanders more often than other generations don’t shop in a store where they have already had poor service during shopping.

The importance of smooth shopping experience, both offline and online, becomes crucial.

“Well curated store with limited number of products” is a perfect shop for Generation Z.

Retail

RUSSIA IS ONE OF THE LEADERS OF NEW CONSTRUCTION IN EUROPE

Even though construction activity is moderate for the last 3 years, Russia remains in the Top-5 countries by construction volume in 2019-2020. Russia holds the second position slightly behind Turkey.

STABLE LEVEL OF NEW CONSTRUCTION

In 2019-2021 construction activity will remain at the level of the past two years - about 500-700,000 sq. m of retail space will be delivered to the market annually.

272

‘000 sq. m

New construction, Q1-3 2019

Russia (including Moscow)

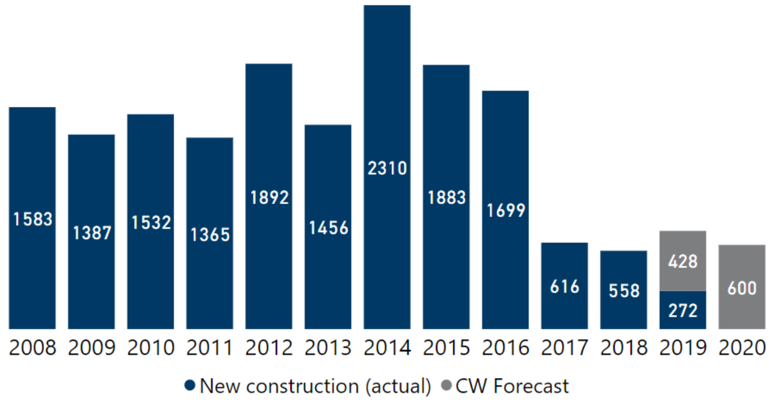
700

‘000 sq. m

New construction, 2019F

Russia (including Moscow)

New construction in Russia (including Moscow), ‘000 sq. m



Source: Cushman & Wakefield

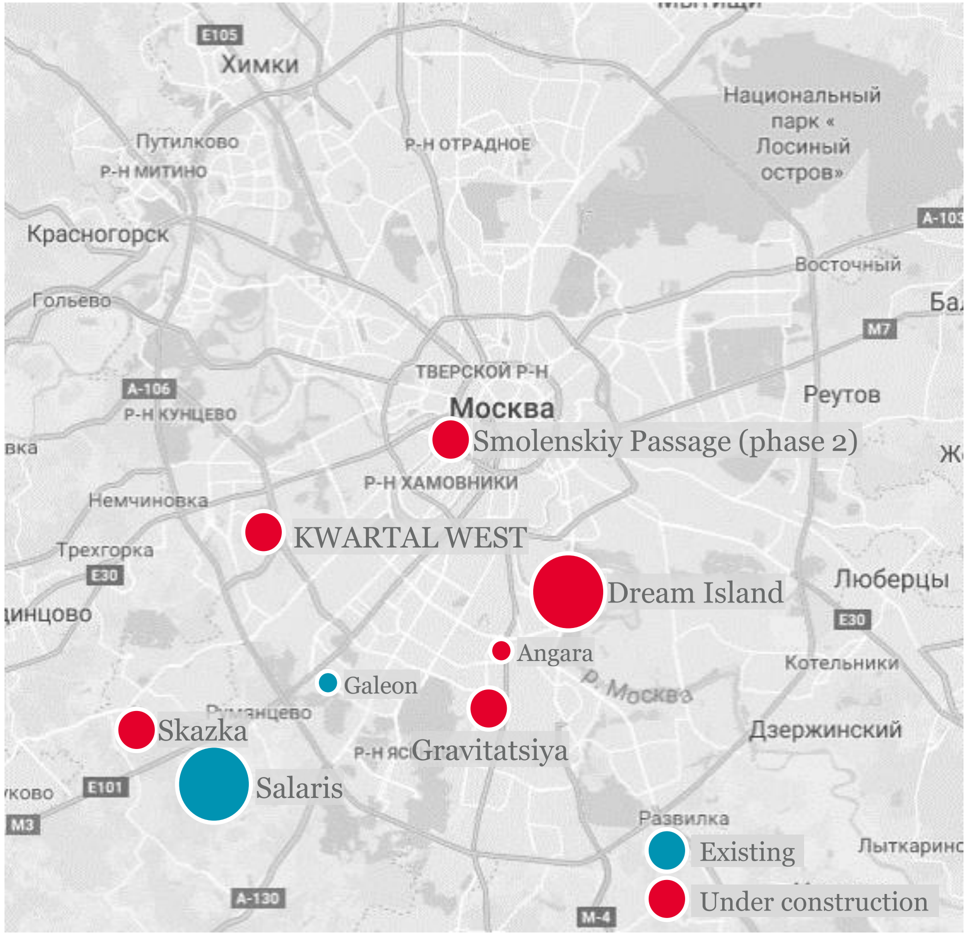
In Q3 2019, four shopping centers with total GLA of 76,000 sq. m were opened in Russia.

Developers are showing more and more interest to concept rethinking and extension of existing properties. Half of the retail schemes opened in Q3 were new phases of existing shopping centers.

We expect new construction to grow significantly in Q4 2019, and to reach 600-700,000 sq. m of retail space by the end of the year. This increase will happen due to the large openings in Moscow.

The remote regions of Russia, in particular Far East, continue to develop. The largest shopping center in the regions (excluding Moscow) planned for opening by the end of the year will be the first phase of Brosko Mall (GLA – 41,000 sq. m) in Khabarovsk. Also, several small shopping centers are under construction in Yuzhno-Sakhalinsk, Petropavlovsk-Kamchatsky and one more retail scheme in Khabarovsk.

Shopping centers opened and planned for delivery in 2019 in Moscow

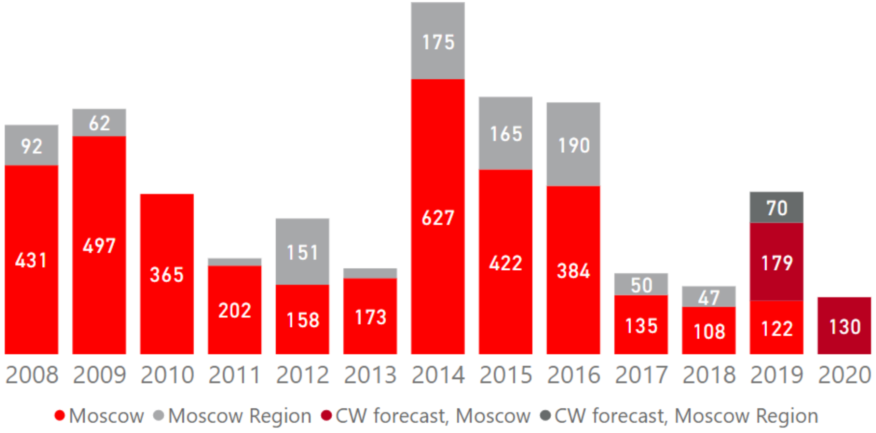


Retail

NEW CONSTRUCTION IN MOSCOW

In 2019, new construction will reach 300,000 sq. m of retail space and will significantly exceed the indicators of the past two years.

New construction in Moscow, ‘000 sq. m



In Q3 2019, one shopping center was delivered to the market in Moscow. It was a soft opening of Galeon shopping center, where Lenta hypermarket started operating.

Low construction activity and increasing occupancy rate in existing shopping centers led to a gradual decrease of vacancy level to 7.7%. However, till the end of the year due to the increase in new construction, we expect the indicator to grow within one percentage point.

RETAILERS CONTINUE TO EXPERIMENT

Lower consumer activity stimulates retailers to search for new sales channels, diversify formats, introduce new technologies and collaborate with other market players.

NEWCOMERS, Q1-3 2019

A BATHING APE SINCE 1993
HACKETT LONDON
LE LABO GRASSE – NEW YORK
GIORGIO MAGNANI Luxury
Off-White™
EA7 EMPORIO ARMANI
JONAK PARIS
GaGà MILANO
RAINS
carter's
RICHARD MILLE
GIOVANNI RASPINI

Shop-in-shop format is becoming more and more popular, helping to increase the footfall and expand the range of goods: operators are testing mini-formats at gas stations (Magnit, Burger King, Hleb Nasuschny), Hoff Home opens shops inside Karusel hypermarkets, the Far Eastern pharmacy chain plans to start operations in Vkusvill.

Retailers are actively experimenting with formats, sometimes in new segments: launch of pharmacy and dry cleaning chains under Spar brand is planned, one of the largest car dealers Major opened the chain of organic goods shops – M2 Organic Club, Magnit opened Magnit Vecherny alcoholic beverages store.

In search of competitive advantages retailers are introducing new technologies – Perekrestok is testing store navigation with augmented reality, Lenta is launching AR-game for customers, Vkusvill launched a cash withdrawal service at cash desks.

LARGEST CHAINS OF PICKUP POINTS

OZON
QIWI Box
PickPoint

According to Data Insight, the share of customer pick up in e-commerce has been growing for the fourth year in a row, which stimulated the development of additional delivery channels, especially pickup points. Delivery points were opened in Sberbank branches, StarPost plans to start installing pickup centers in residential buildings, Pyaterochka will allow to pick up the orders from Beru marketplace at their cash desks, Ozon is going to open points of delivery in Obuv Rossii stores.

COMMERCIAL TERMS

In general, commercial terms remain at the same level as the last year. The prime segment shows moderate growth.

170 ‘000

RUB / sq. m / year

Prime rental rate indicator - base asking rental rate for a 100 sq. m gallery unit on the ground floor of prime shopping centers

12-15 %

of turnover

Average rental payment for an operator in retail gallery

Source: Cushman & Wakefield

Rental rates in prime shopping centers *

Tenant type	Average rental rate, RUB/ sq. m / year	
	Min	Max
Hypermarket	-	8 000
DIY	-	10 000
Entertainment center	-	14 000
Cinema	6 000	12 000
Fashion (anchor)	-	15 000
Retail gallery unit	20 000	250 000
Fitness center	6 500	10 000
Restaurant, café, coffee shop	20 000	150 000
Food court	75 000	170 000

*Average rental rates for successful shopping centers in Moscow. The data can be used only for estimation of the level of rental payments.

The most common structure of rental payments is a compound rental rate – either a minimum fixed rent or a percentage of the turnover of the tenant (whichever is higher) is used as a rental payment. “Net” percentage of turnover (without fixed payment) is almost never used as a method of payment, it is sometimes used for large anchor tenants (hypermarkets, entertainment, cinema). However, different payment schemes are used in different shopping centers – in some properties these types of tenants also pay fixed rent.

Average percentages vary from 12% to 15% for retail gallery operators, and from 3% to 7% for large anchor tenants.

Section 2

WAREHOUSE AND INDUSTRIAL

- The share of speculative construction in the Moscow region remains low.
- Developers are experimenting with new formats of warehouses.
- Against the background of low speculative construction in the Moscow region, vacancy rate continues to decline.

MOSCOW, CLASS A

	Q1-Q3 2019	2019 (forecast)
Stock (‘000 sq. m)	13,345	13,600
New construction (‘000 sq. m)	389	800
Vacancy rate (%)	3.7	3.5
Rental rate * (RUB / sq. m / year)	3,800	3,900
Take up (‘000 sq. m)	1,302	1,800

REGIONS, CLASS A

	H1 2019	2019 (forecast)
Stock (‘000 sq. m)	9,650	9,840
New construction (‘000 sq. m)	312	450
Take up (‘000 sq. m)	504	650

** Average rent excluding OPEX, utilities and VAT*
Source: Cushman and Wakefield

Warehouse & Industrial. Moscow region

SPECULATIVE CONSTRUCTION REMAINS LIMITED LEADING TO DECLINE OF VACANCY RATE

DELIVERY OF WAREHOUSE PROJECTS IS POSTPONED TO THE END OF THE YEAR

Moscow region: in Q4 2019 the new construction will be higher than in the first three quarters in total.

389

'000 sq. m

New construction, classes A&B

Q1–3 2019

800

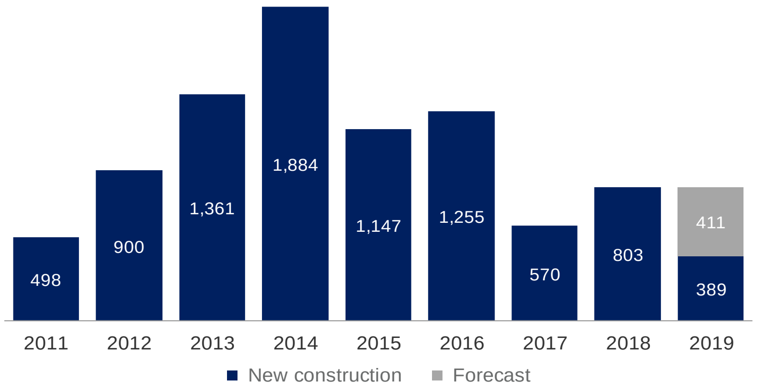
'000 sq. m

New construction, classes A&B

Forecast for 2019

Source: Cushman & Wakefield

New construction, classes A&B, '000 sq. m



Within the first 9 months 389,000 sq. m of new space were added to the total stock in the Moscow region. However, in Q4 2019 we expect new construction to increase significantly - 411,000 sq. m of warehouse space will be delivered to the market.

As a result, new construction by the end of 2019 will reach the level of 2018 - 800,000 – 850,000 sq. m of warehouse space.

The south of the Moscow region is the most demanded and actively developing direction. During the first 9 months, 40% of new construction was concentrated there.

In Q3 2019, new project - PNK Park Medvedkovo - was announced. This project will be constructed within the city borders and will be the first example of urban logistic project delivered by a federal developer. This project will be developed in a new format of multistory building. The first warehouse property of this type was PNK Veshki by PNK Group which was leased to Vkusvill.

In Q3, one of the first light industrial complexes in Russia was constructed in Synkovo logistic park. This project is in high demand among buyers and tenants as it is one of the first projects of this type in Russia fully developed according to European standards.

VACANCY RATE CONTINUES TO DECLINE

Moscow region: due to low share of speculative construction vacancy rate has decreased by 1.4 p.p. since the beginning of the year.

3.9%

Vacancy rate, class A

October 2019

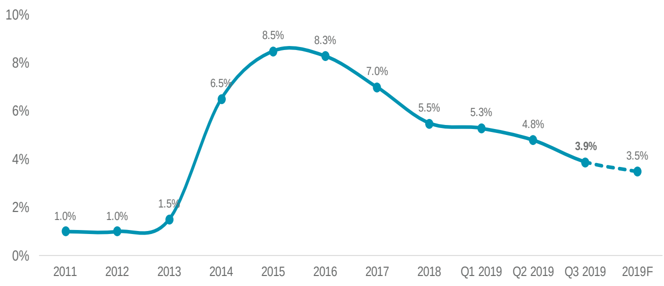
3,800
RUB / sq. m / year

Rental rate, class A

October 2019

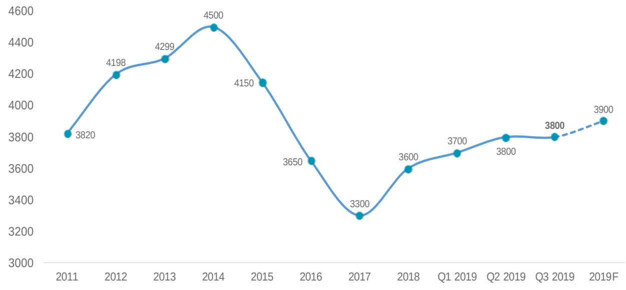
Source: Cushman & Wakefield

Vacancy rate, class A



Due to low share of speculative construction – less than 50% in 2019 - vacancy rate continued to decline and reached 3.9%. The largest share of vacant space is concentrated in the South of the Moscow region – 181,000 sq. m, which amounts to 3.5% of the total stock in this direction. The lowest vacancy rate was recorded in the North-East.

Rental rate, class A, RUB / sq. m / year



At the end of Q3 2019, the average rental rate for class A is 3,800 RUB per sq. m per year.

In Q3 2019, against the background of continuing decline in the vacancy rate and high tenant activity we see that some developers are already raising asking rental rates, which leads to a smooth growth of average rental rates. We expect the average rental rate to reach 3,900 – 4,000 RUB per sq. m per year at the end of 2019 – beginning of 2020.

* Average rental rate excluding OPEX, utilities and VAT

THE SOUTH OF MOSCOW REGION REMAINS THE MOST ATTRACTIVE DIRECTION FOR LEASE OR PURCHASE

Moscow region: in Q1-Q3 2019 more than 35% of all transactions were made in the South of the Moscow region.

1,302

'000 sq. m

Take up, class A and B

Q1–Q3 2019

14.4

'000 sq. m

Average deal size (lease and sale)

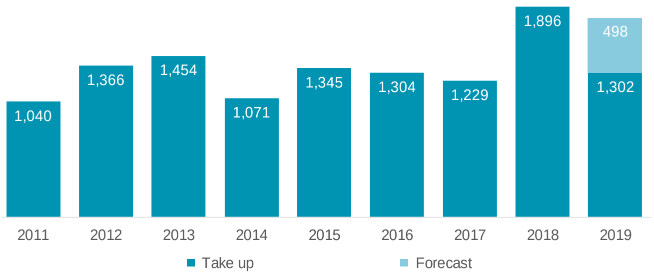
Q1–Q3 2019

Source: Cushman & Wakefield

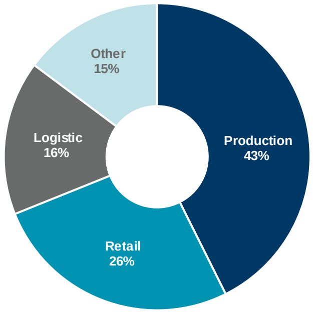
The share of purchase transactions in Jan-Sept 2019 amounted to 16% of the total take up. The average transaction size was 19,100 sq. m. In the take up structure, manufacturing companies accounted for 45%, and retailers for 27%. The most active consumers were Russian companies- - 57% of all transactions while share of foreign companies amounted only to 43%.

Lease transactions comprised 84% of the total take up. The average size of a lease transaction is 13,800 sq. m. Retailers are the largest players in the leasing market of quality warehouse space (46% of transactions). In the first 9 months of 2019 the most attractive direction for lease or purchase of warehouse space was the South of Moscow region - more than 35% of transaction volume.

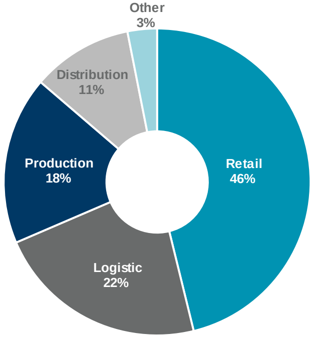
Take up, classes A&B , '000 sq. m



Take up structure (sale), classes A&B



Take up structure (lease), classes A&B



Warehouse & Industrial. Russian regions

ALMOST HALF OF REGIONAL TAKE UP IS CONCENTRATED IN THE LENINGRAD REGION, WHILE NEW CONSTRUCTION REMAINS LOW

TAKE UP IN REGIONS REMAINS HIGH

Regions: in Q1-Q3 2019, the take up was higher than during the same period of 2018 by almost 1.5 times.

312

‘000 sq. m

New construction, classes A&B

Q1–Q3 2019

504

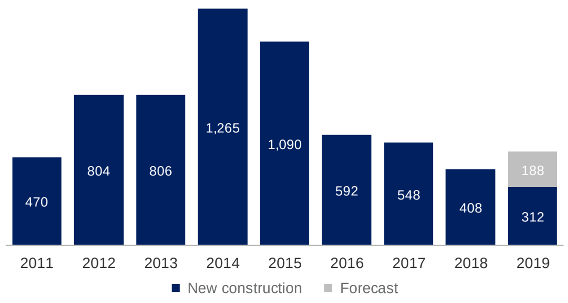
‘000 sq. m

Take up, classes A&B

Q1–Q3 2019

Source: Cushman & Wakefield

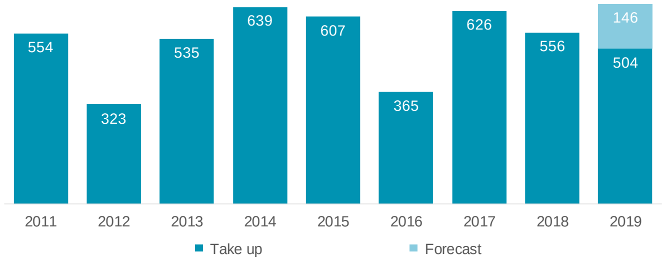
New construction, classes A and B, ‘000 sq. m



In Jan-Sept of 2019, 312,000 sq. m of warehouse space was delivered to the market. 83% of this volume was covered by new construction in Novosibirsk, Sverdlovsk and Leningrad regions.

In Q4 2019, we expect another 188,000 sq. m to be completed in the regions. By the end of 2019, the volume of new construction will exceed the figure of 2018.

Take up, classes A and B, ‘000 sq. m



In Q1 – Q3 2019, 504,000 sq. m of warehouse space were leased and purchased, which is almost 1.5 times higher than in 2018. Almost 42% of deals were closed in the Leningrad region (213,000 sq. m).

The main demand in the regions comes from retailers – 62% of all transactions. The largest deal is still the purchase by Lenta in Orientir-South warehouse complex in St. Petersburg (69,000 sq. m). The purchase deal in PNK Park Sofiyskaya in St. Petersburg (51,000 sq. m) by Marvel was the key event of Q3 2019.

KEY PROPERTIES AND TRANSACTIONS

Moscow and regions

Key warehouse properties delivered to the market in Q1 – Q3 2019

Property	Region	Total area
Moscow region		
IKEA Esipovo	Moscow	90 000 sq. m
PNK Park Valischevo (Lenta)	Moscow	68 519 sq. m
Vnukovo II (Pochta Rossii)	Moscow	50 250 sq. m
Wildberries DC	Moscow	48 900 sq. m
Regions		
SK Sibirsky	Novosibirsk	60 000 sq. m
Logopark Vysota	Ekaterinburg	47 285 sq. m
DC X5 Tolmachevo	Novosibirsk	38 500 sq. m
Osinovaya Roscha	St. Petersburg	38 000 sq. m

Key warehouse properties will be delivered to the market in Q4 2019

Property	Region	Total area
Moscow region		
PNK Beliy Rast (Leroy Marlin)	Moscow	140 000 sq. m
PNK Park Veshki	Moscow	87 000 sq. m
Wildberries DC	Moscow	53 000 sq. m
Atlant park	Moscow	50 000 sq. m
Regions		
Rolsy	Ekaterinburg	50 370 sq. m
Freight Village Vorsino	Kaluga	37 700 sq. m
Logopark M10	St. Petersburg	28 000 sq. m
Logopark Arbuz	Volgograd	27 000 sq. m

Section 2

HOSPITALITY

- A slow start of the year turned into an active Summer season for the Moscow hotels. As a result, during Q3 2019, city hotels registered monthly increases in Occupancy and ADR vs. previous periods (net of the 2018 World Cup months).
- Q3 2019 saw no new modern quality rooms opened.
- Despite a slow start of the year, YTD Sept results registered positive dynamics in all main operating performance indicators for the Wider market (Occupancy – 77.9%, ADR – RUB6,685) vs. 2017. Compared to the last pre-World Cup full-year period of stabilized trading, Occupancy levels added 5.6 ppt, ADR increased by 4.0%, and Revenue per Available Room grew by whopping 12.1%.

57.3K keys

Overall estimated classified room stock (net of hostels and serviced apts)

Cushman & Wakefield's estimates based upon data by the Moscow City Hotel & Tourism Department, Q3 2019

20.2K keys

Modern quality room stock

Cushman & Wakefield's estimates, Q3 2019

0 keys

In new hotels in Moscow

Net room stock increase in Q3 2019

0 keys

In new hotel projects

Net room stock expected in Q4 2019

MINIMAL GROWTH OF THE MARKET IN 2019

440 new rooms planned to open in 2019 shifted to 2020.

0 keys

Supply increase in Q3 2019

New hotel openings moved to 2020

New supply in Moscow in 2019

Hotel project	Keys	Opening
Holiday Inn Express Baumanskaya	128	Q1
Total	**128**	

Source: Cushman & Wakefield

NO BIG INCREASES IN NEW SUPPLY EXPECTED OVER MID-TERM

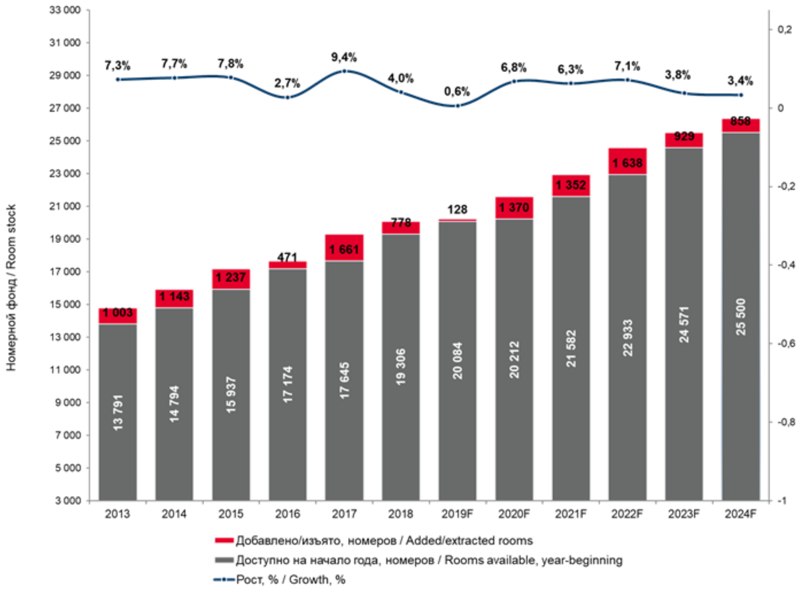
Net hotel stock gain in 2019 limited to 128 keys.

0.6 %

Year-on-year growth in 2019

Expected market growth in 2019

Supply growth dynamics – actual and projected



Source: Cushman & Wakefield

Compared to a 4-percent increase of the market pie in 2018, 2019 will see growth under 1%, the worst result over the last decade.

In the absence of noticeable improvements to the health of the national economy, hotel developers continue to push construction launches further and further down the road. As a result, the Moscow market's average annual growth rate in 2020-2024 is generally expected to remain at a very average 5.5%.

"GOLDEN RULE" FOR HOTELS - IN ACTION

Demand growth is registered across all market segments but main beneficiaries – hotels around Kremlin.

5.6 ppt

Change in Occ, YTD Sept 2019 vs. YTD Sept 2017

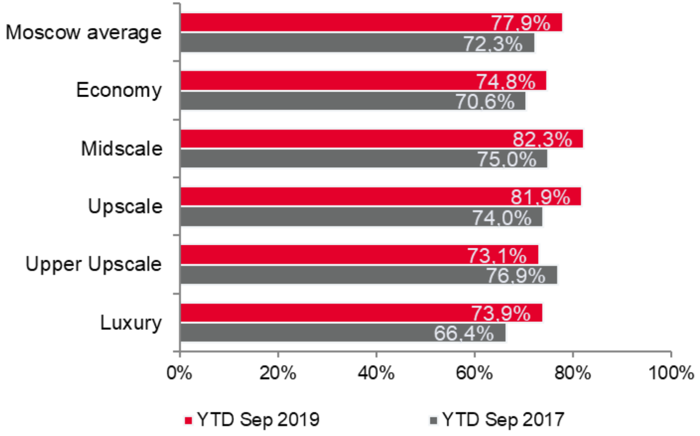
Wider market

4.0 %

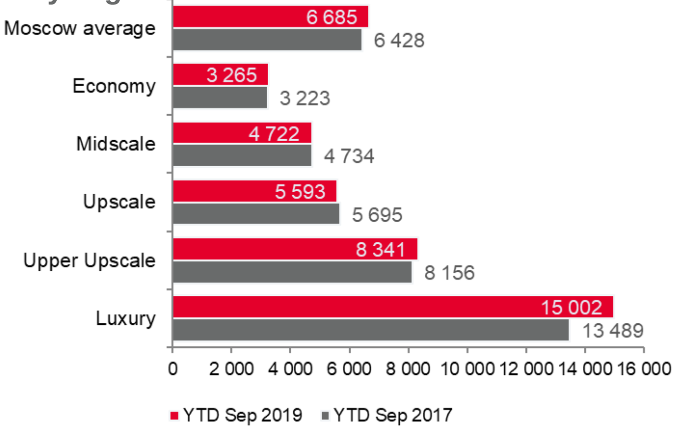
Change in ADR (RUB), YTD Sept 2019 vs. YTD Sept 2017

Wider market

Occ, YTD Sept 2019 vs. YTD Sept 2017, by segment



ADR (RUB), YTD Sept 2019 vs. YTD Sept 2017, by segment



Compared to 2017 (the last period prior to the World Cup), over 9 months of 2019 Moscow hotels registered good gains in Occupancy (4-8 ppt) in all price segments but one. The Upper-Upscale category lost 3.8 ppt due to a rapid expansion (nearly 700 keys added) over the last two years.

The 4-percent growth of ADR levels, however, can be called impressive only if one ignores the factor of inflation. In reality, however, if one discounts the 11.2% gains posted by the Luxury hotels (highly attractive for leisure visitors during summer due to their location around the Kremlin), the rest of the Wider market's ADR added merely 0.5%. Such variability of results only confirms the "golden rule" (the importance of locational factor) in the hotel business.

Source: Cushman & Wakefield

CONFIDENT ROOM YIELD GROWTH

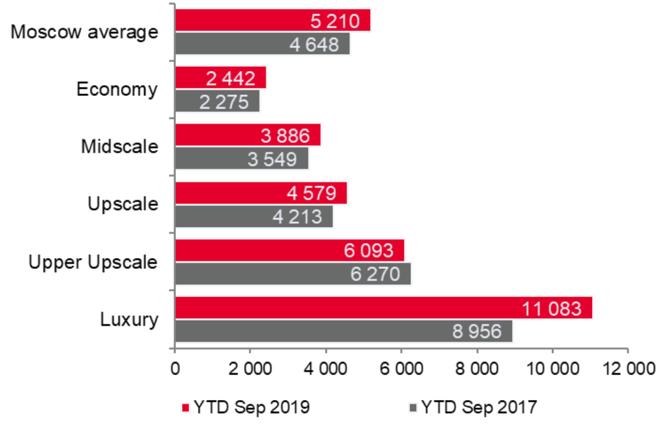
12.1 % **Change in RevPAR (RUB), YTD Sept 2019 vs. YTD Sept 2017**

Wider market

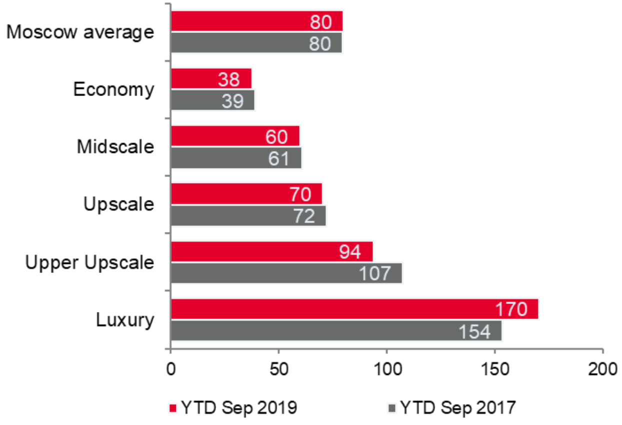
0.5 % **Change in RevPAR (USD), YTD Sept 2019 vs. YTD Sept 2017**

Wider market

RevPAR (RUB), YTD Sept 2019 vs. YTD Sept 2017, by segment



RevPAR (USD), YTD Sept 2019 vs. YTD Sept 2017, by segment



A confident growth in Room Yield for the Wider market (12.1% vs. the same period in 2017) is driven mostly by increases in Occupancy, and only in Luxury hotels, a 24-percent RevPAR growth recorded in Aug 2019 was determined by an ADR growth. Upper-Upscale hotels remain the only losing segment posting a 2.8% decline in Room Yield (since the recently opened properties, jointly adding nearly 700 keys, are still at ramp-up period).

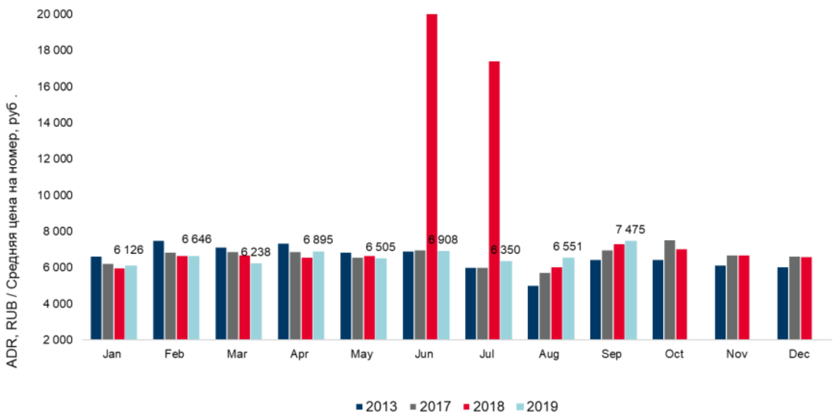
USD-denominated RevPAR data shown on the second graph is provided only for informational purposes, its dynamics driven solely by FOREX volatility.

Source: Cushman & Wakefield

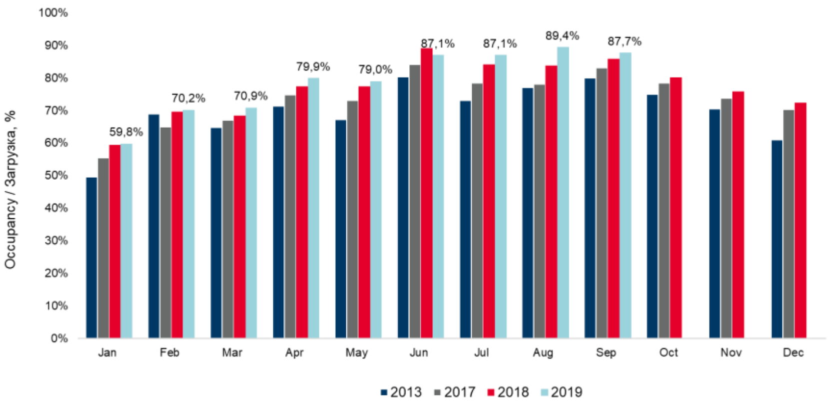
CAN VISITATION GROWTH PUSH ROOM RATES UP?

What can Moscow hotels reasonably expect in 2020?

ADR dynamics (in RUB), by month



Occupancy dynamics, %, by month



A slow start of the year, traditional for the Moscow market, ended by April 2019, and from July 2019, room rates (pushed by the active leisure demand growth) finally started demonstrating signs of recovery – see the graph above.

A combination of strong leisure demand and an overlapping MICE demand generated by several large-scale federal-level events, helped Luxury hotels, mostly concentrated around the Kremlin (a key factor for affluent tourists), to optimize both Occupancy and ADR levels. As a result, in Aug 2019, Luxury hotels recorded a 28-percent gain in RevPAR.

However, few leisure visitors are generally prepared to pay top accommodation rates. With this in view, it remains unclear how much the expected launch of the electronic visa regime in Moscow, which the City intends to pilot-case already in 2020 (in the other regions of the Russian Federation, according to Zarina Doguzova, Head of Rostourism, electronic visas will be effective at 1 Jan 2021,), will impact ADR growth.

Source: Cushman & Wakefield

STANDARD COMMERCIAL TERMS

LEASE TERMS

DURATION OF LEASE
Offices: 3-7 years
Industrial: either short-term (1-3 years) or long-term (5+ years)
Retail: 3-5 years, anchor tenants - 7-10 years.

BREAK OPTION
Offices: Possible after 3 years with penalty. After crisis became very popular. Notice period is 6-12 months. Contract can be terminated from both sides.
Retail: Possible after 2-3 years, subject to negotiation with landlord.

DISPOSAL OF LEASES

ASSIGNMENT AND SUB-LETTING
Offices & Industrial: Usually possible, but subject to negotiation.
Retail: Not common, in some cases subject to negotiation.

FEES

Agent service fees:
Offices: depends on the type of service and type of deal, **Retail**: 8-12% of the annual lease payment, **W&I**: lease - 1-2 months of lease payment, acquisition – 2-3%.
Land: acquisition- 3-5% depending on the land plot size.

MEASUREMENT PRACTICE

Space is measured generally on the BOMA system. Some Landlords apply BTI (Bureau of Technical Inventory) measurements.

RENTAL PAYMENTS

RENT PAYMENT AND FREQUENCY
Offices and retail: RUB or US$ per square meter per year, payable due monthly or quarterly in advance.
Industrial: Rubles.

RENT DEPOSIT
Offices: 3 months rent equivalent (bank guarantee optional, very seldom as landlords prefer the deposit).
Retail: 1-2 months rent equivalent (bank guarantee optional).
Industrial: 1-3 months rent equivalent (bank guarantee optional, very seldom as landlords prefer the deposit)

RENT REVIEWS
After crisis have become more popular, negotiable.

INDEXATION
Offices: at the level of Russian CPI or 4-7% for RUB agreements; 2.5-4% or at the level of USA / EU CPI for agreements in foreign currency.
Retail: 5-10% or CPI in Russia for RUB agreements, 2-5% or US CPI for agreements in USD.
Industrial: 4-8% (for agreements longer than 5 years not more than 5-6%).

TURNOVER RENTS (only in **Retail**):
Compound rental rates (minimum fixed rent + a percentage of turnover) are almost always used in shopping centers. Normally, the percentage of turnover varies between 12-15% for fashion, 1-3% for anchor tenants.

SERVICE CHARGES, REPAIR AND INSURANCE

REPAIR
Tenant: Internal repairs and maintenance.
Landlord: Structural repairs, common areas.

INSURANCE
Tenant: Contents insurance.
Landlord: Building insurance which is normally charged back to tenant via the service charge.

SERVICE CHARGES
Service charge is payable by the tenant at either an ‘open book’ basis or as a fixed cost.

UTILITY EXPENSES
Often not included into service charges, but depends on landlord and different types of projects.

Retail: in some cases, service expenses can be increased due to the regular growth of utility expenses after provision of supporting documents.
Industrial: usually paid separately on the basis of actual consumption.

TAXATION

REAL ESTATE TAX
Landlord: the tax depends on the region. In Moscow amounts to 1.6% in 2019 (1.7% in 2020, 1.8% in 2021).

Tenant: can be partly or fully included to service charges paid by tenant.

VAT: 20% (from January,1 2019)

#MARKETBEAT

Section 3

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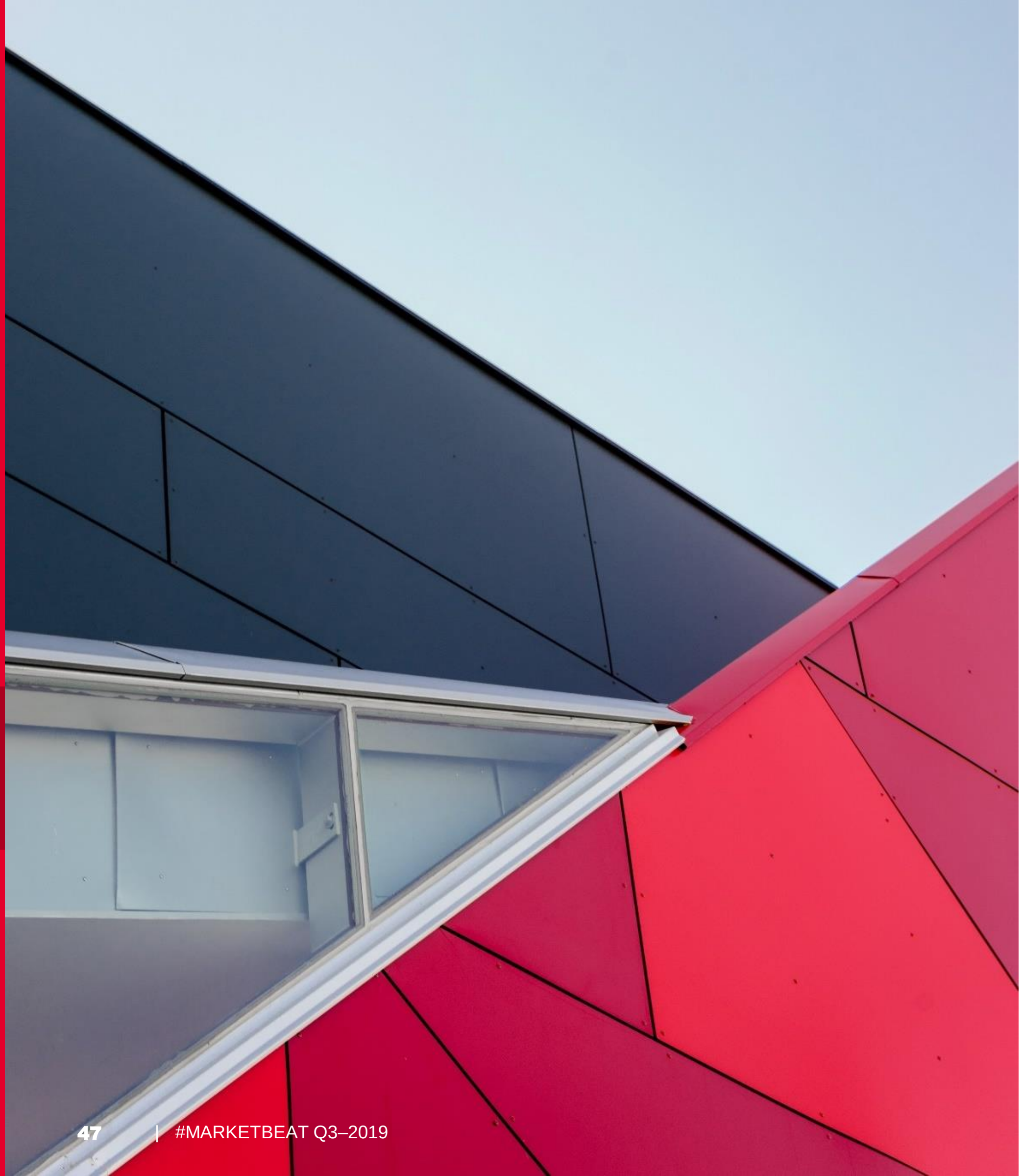

About the company

CUSHMAN & WAKEFIELD IN RUSSIA

Cushman & Wakefield has been successfully operating in Russia since 1995, with more than 150 experienced and highly qualified expert employees. The Moscow office implements projects in all major cities in Russia and the CIS, forming transnational teams for solving complex tasks when necessary. There are 12 key areas of company activity, covering all the sectors of commercial real estate: offices, retail, warehouses, hospitality and tourism, land. The range of services provided includes the leasing of spaces, asset management, investment consulting, real estate operation, services for corporate clients, project management, development consultancy, representing tenant's interests, valuation, hospitality and tourism. Cushman & Wakefield is one of the largest companies in the global commercial real estate market, with a turnover of $6.9 billion and a team of more than 48,000 specialists in more than 400 offices in 70 different countries. For more information, visit our websites – www.cwrussia.ru and www.cushmanwakefield.ru

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