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#TRENDSRADAR

13.04.2020

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OXFORD ECONOMICS

Forecast as of 09.04.2020

MACRO

- The forecast is noticeably downgraded last week.
- The base case scenario shows rebound in 2021.
- The unemployment rate is expected to grow from 4.6% in 2019 to 6.12% in 2020. Unemployment will peak in summer.
- Consumer market had been weak for several years, even before the quarantine. It is unlikely that the 2013 sales volumes will return in observed future.
- Ruble devaluation and social support programs push inflation up while contracting consumption and loss of personal income will restrain retailers from noticeable price growth.

-6.3%

GDP 2020

More downward reviews are expected in May

-8.4%

Retail sales 2020

The volume of loss will be more evident in May

??

CPI

Official forecast is 4.01%, but the real figure is unpredictable now

$29.9

Oil price

Average price, forecast for 2020

Источник: Oxford Economics, 09.04.2020

ON RADAR: ECONOMY

Base case forecast: V-shape – a sharp drop in 2020 and return to the previous levels in 2021. This is a positive scenario for the Russian market. The depth of the fall is not as important as the speed of rebound.

Short-term forecast

- Unemployment is important indicator to monitor.
- A number of the poorest regions in Russia will need to return to the economic activity.
- Regions of Russia are not well-connected with each other. This factor can prevent the spread of virus.
- Negative effect of frozen business activity will be noticeable in April. It will be strengthening until the summer.
- The major risk zones are a shortfall of personal income and obligations on mortgage and household debt.

Mid-term forecast

- In the positive scenario, we will see the bottom of the crisis in Q2. If the situation moves ahead and hits the bottom by the end of the year, there will be a prolonged recession in Russia.
- Additional capitalization of banks due to the increase of bad debts.
- Unemployment rate growth.
- Additional measures of social support will be sporadic and oriented on selected social groups.

Recommendation:

Use 2 year cycle for financial modelling, considering zero growth of the economy over 2-year term and annual inflation at the level of 5-7%.

ON RADAR: REAL ESTATE

The scale and the cycles of structural changes differ from segment to segment. New cycles will form on the market.

Segment	Current situation	June 2020	End of 2020	Post-pandemic
Offices	*	**	***	*****
Retail	*****	***	**	**
W&I	**	**	*	*
Residential	**	***	****	**

* Minimum changes
***** Maximum changes

The impact of pandemic on different segments is not the same. In the short-term perspective the main factor of influence is administrative restrictions; in the mid-term – economic recession; in the long-term – social changes.

- Offices are less affected by the short-term impact, but in the end this market might change most of all.
- Warehouses play an increasingly important role, taking the market share from traditional retail. In the long-term, the effect will be at the minimum level.
- Retail was hurt most of all on the first stage, however this effect will smooth in the long-term.

ON RADAR: CAPITAL MARKETS

Due to low investment activity during the last years the pandemics effect will be subdued.

Short-term forecast

- Ongoing deals from the last year are still active.
- No new deals are being negotiated on the market.
- There will be no noticeable repricing in ongoing deals as currency risks are hedged.

Mid-term forecast

- Potentially investment activity will grow up in Q4 2020, but deals will be most likely moved to 2021.
- Redistribution of property, sale of non-core and toxic assets – we will see all of this in the second half of the year.

Oleg Takoev, Partner, Capital Markets, talks about specifics of the investment market:

- current status of the ongoing deals,
- how to prepare a property for sale,
- whether we will see the renaissance of hypermarket format,
- how to save the money.

«Investors being active on the market for last ten years are still selling and buying. Even in the current circumstances we see ongoing due diligence processes, finalization of buy&sale agreements. If we compare the current situation with 6-12 months back, we can say that the buyers are much more exacting and selective.»

For more insights on the capital markets watch [IQ interview] with Oleg Takoev

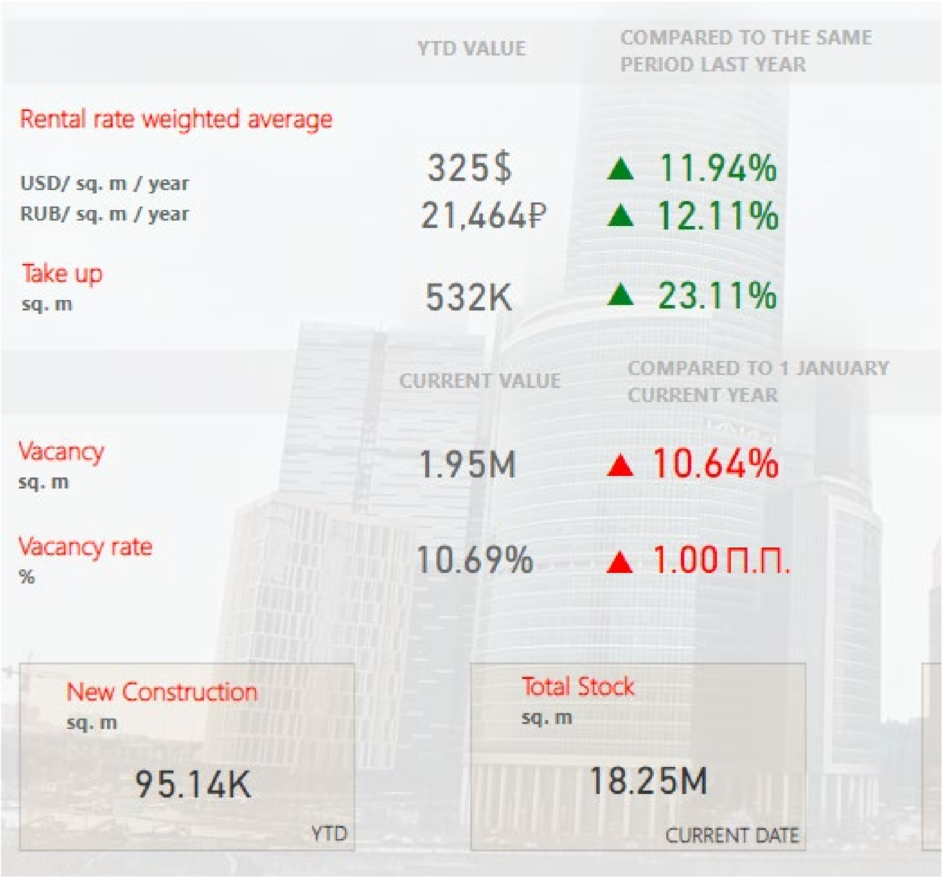
Recommendation:

For owners – to prepare assets for sale more attentively including restructuring of rental income and legal due diligence.

Offices

WORKPLACE PERCEPTION IS GOING THROUGH TRANSFORMATION

Office indicators as of 13.04.2020



Source: Cushman & Wakefield

For more information follow the link

Offices

CURRENT SITUATION

All indicators remained stable and showed positive YTD dynamics.

Year-To-Date indicators as of 13.04.20:

- Take-up exceeded the same indicator of 2019 by 23%.
- The weighted average rental rate (RUB equivalent) exceeded last year's figure by 12%.
- New construction in Q1 2020 tripled the figure of Q1 2019 and amounted to 95,142 sq. m. 35% of the new construction volume is represented by BC Suvorov Plaza which is occupied by Sberbank.
- A significant number of office deals in Q4 2019 led to the increase of vacant office space in Q1 2020. As a result, absorption amounted to -92,000 sq. m.

Offices

FORECAST

Take-up and new construction for 2020 were reduced once again due to slowdown of business activity in Q2 2020.

1.6 mn sq. m -20%*

Take-up (lease and sale deals)

2020F

220 -30%*

'000 sq. m

New construction

2020F

20,100 -1,5%*

RUB / sq. m annum

Average rental rate (Ruble equivalent)

2020F

Source: Cushman & Wakefield

** % of change from the previous forecast as of January 2020*

- We expect a temporary decrease in construction activity. Some completions will be postponed until the next year. The new construction forecast was reduced by 8% compared to the previous publication of #TRENDSRADAR (03.04.20).
- Take-up forecast was reduced by 5% compared to the previous #TRENDSRADAR publication due to a slowdown of business activity in H1 2020. We expect demand to flatten out by the end of the year.
- The tight supply of high-quality consolidated office blocks and construction activity decrease will support rental rates. Average rental rate forecast was not changed over the last week.

#TRENDSRADAR 03.04.20 is available at www.cwrussia.ru

Workplace strategy becomes one of the key tools for office space optimization

Nowadays many companies will be focused on optimization of occupied space. That suggests vacancy rate increase and a steep surge in demand for flexible workspace. Effective workplace strategy will be a key tool that will help companies to adapt to new market realities.

ON RADAR: OFFICES

Although short-term effect is minimal, major office segment changes will come up in the long-term period.

Short-term forecast

- Drop in demand.
- Stable rental rates.
- Steep surge in demand for flexible workplace.
- Rental rates in low-quality properties will be under intense pressure.
- Insignificant activity in lease terms optimization.

Mid-term forecast

- Increased activity in lease terms' review.
- Slowdown of demand for flexible workspace.
- Further compression of rental rate' spread between the center and the second belt.
- Intensive formation of new office clusters on the periphery.
- Structural changes of the market.

Recommendation:

- Either a long-term strategy focused on the post-crisis period, or short-term strategy, aimed at solving today's problems.
- Flexibility and Agile for both tenants and landlords.
- Landlords should consider scenarios of dramatically transformed demand.

EXPERT OPINION

For more insights on the office market watch IQ Interview with Natalia Nikitina, *Partner, Head of Office Group Cushman & Wakefield*

Retail

TENANTS, LANDLORDS AND THE GOVERNMENT ARE TRYING TO REACH A COMPROMISE

CURRENT SITUATION

Measures of the government support remain unobvious and don't cover all categories of retailers. It is not clear if the landlords of shopping centers will receive any support.

70 '000 sq. m

New construction

Moscow, April 2020

-30%*

200 '000 sq. m

New construction

Moscow, 2020F

7,6 %

Vacancy rate

Moscow, April 2020

+2-7p.p.*

10-15 %

Vacancy rate

Moscow, 2020F

** % of change from the previous forecast as of January 2020*

$ RENTAL PAYMENT PROLONGATION

On April 6, 2020, the Russian Government issued the Decree, which suggests landlords to receive prolonged period for the tax (property and land) and land rent payments. Landlords will be able to use the benefits if they agree for a deferred rental payments for the tenants in their shopping centers (100% during the high-alert regime or emergency situation, 50% - after the high-alert regime or emergency situation and until October 21, 2020). The decree also recommends to consider the discounts on rental payments.

The decree applies only to companies from the list of the most affected by COVID-19 industries, published earlier by the government (includes catering, travel agencies and consumer services, etc.).

In practice, landlords and tenants are looking for their own ways out of the current situation – discounts on rental payments or rental holidays are provided to the closed stores. However, not all landlords are ready to negotiate.

There is still no understanding if the landlords will get the government support on their credit payments.

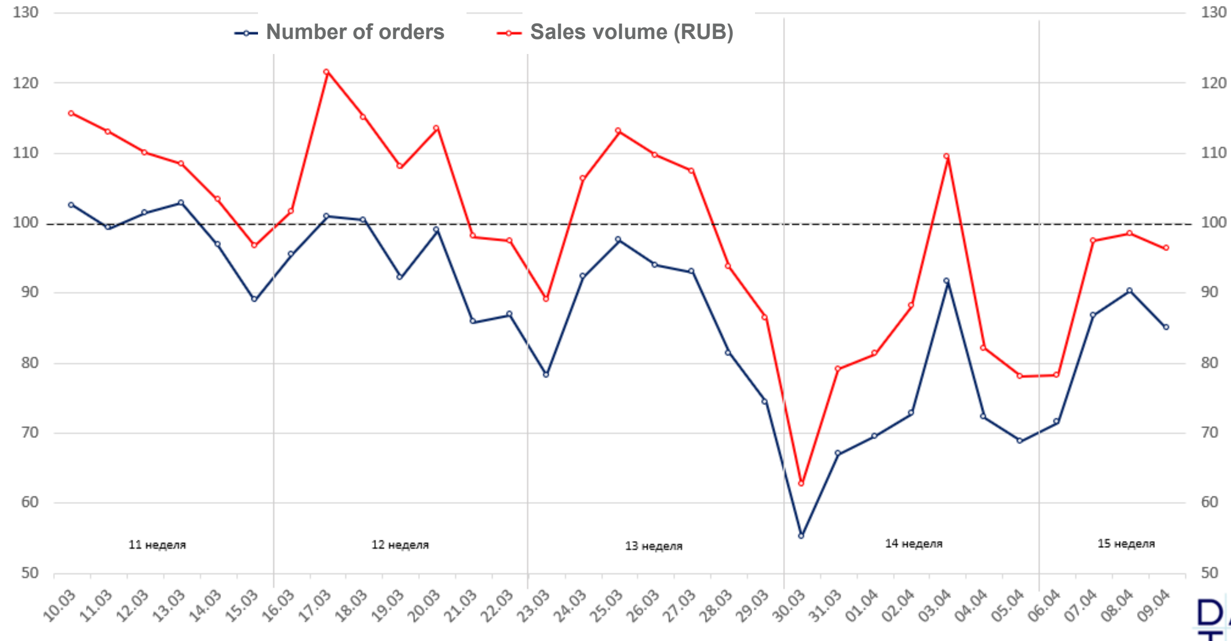
CONSTRUCTION PERMISSION PROLONGATION

On April 6, 2020, the Government issued the Decree that provides a one year extension of the construction permits that expire before January 1, 2021.

FORECAST. ONLINE RETAIL

Self-isolation will stimulate the segment development, however the problems in business scaling and weak consumer market will hold back the explosive growth.

Daily index of online retail
(100 points = level of 25.02-02.03.2020)



Source: Data Insight

The indicators on the graph are daily comparison with the base pre-coronavirus week – 25.02-02.03.2020.

- @ Online retail growth due to the peak sales of essential goods, is slowing down; we don't see booming growth.
- @ The number of orders is declining, while sales volume increased - people started to make large purchases for 1-2 weeks in advance due to increased delivery periods.
- @ The delivery aggregators are actively developing – Yandex.Eda is entering to 32 new cities, Yandex.Taxi has started to deliver goods from Leroy Merlin and Vkusvill, Sbermarket launched delivery of medicines.
- @ After the pandemic, consumers will be back to the shopping centers and we will see the pent-up demand effect. E-commerce will continue to develop actively. However, the short-term growth will not be enough to increase the share of online trade in annual retail turnover.

EXPERT OPINION

Oxana Mostyaeva

Head of Retail Agency in Cushman & Wakefield

To try “a new taste”

«The self-isolation period will encourage many of us to try “a taste” of online retail: some people will become addicted, some won’t like it. Many people will choose to combine – purchase certain goods online only, but for some products they will be ready to cover kilometers.

There is no doubt that the demand for online will grow – not only for retail, but also for education, art, self-development. We are now in the Era of self-development and self-education. The crisis will become the breakaway point and the start of new opportunities and interests.

As for retail, I suppose, that only operators, that have both platforms well-developed, will survive. Online and offline should not compete, but support each other and operate in synergy».

ON RADAR: RETAIL

The segment will face a serious shock in the short-term, the situation will stabilize by the end of the year.

Short-term forecast

- Paralyzing in the operation of all retail formats, except grocery stores and shops selling essential goods.
- Almost no rental flow in retail schemes.
- Increase in turnover of grocery operators.
- Short-term growth in sales of individual online retailers.

Mid-term forecast

- Shopping centers reopening.
- Annual retail sales decline.
- Decrease in shopping centers traffic compared to the previous year.
- Pent-up demand in the second half of the year.

Recommendation:

- Short-term softening of lease conditions in order to save the key tenants, which will guarantee the minimum necessary flow of costumers after the end of the lockdown.

Warehouse & Industrial

FOOD AND ONLINE RETAILERS ARE DRIVING DEMAND IN THE WAREHOUSE SECTOR

CURRENT SITUATION

The short-term demand increase from retailers had no effect on take-up. Basically, the largest share of requests went through existing agreements with logistic operators.

320,000 sq. m

Take-up (lease and sale deals)
Q1 2020

>70 %

Share of food and online retailers in Take-up
Q1 2020

Source: Cushman & Wakefield

- At the end of the Q1 2020 the take-up reached 320,000 sq. m, which is 19% lower than the same indicator of Q1 2019.
- The largest share of increased demand from food and online retailers in March went through existing agreements with logistic operators. However, several retailers signed short-term agreements for additional space. For instance, online retailer Wildberries signed two short-term agreements for additional space in Klimovsk and Krekshino logistic parks - 35,000 sq. m in total.
- Ongoing long-term projects are still active despite the current market condition.

For more insights on the W&I market watch
***IQ Interview** with Partner, Head of Warehouse & Industrial department of Cushman & Wakefield*
Egor Dorofeev

FORECAST

In the nearest weeks the growth of tenants' requests for temporary optimization of lease terms will increase rapidly.

-30%*

665,000 sq. m

New construction
2020F

-2.4%*

4,000

RUB / sq. m annum

Average rental rate
Forecast for December 2020

0%*

2.8 %

Vacancy rate
Forecast for December 2020

Source: Cushman & Wakefield

** % change from the last forecast of 01.01.2020*

We expect construction costs to increase due to ruble devaluation, which will lead to economic inefficiency of some new projects. As a result construction will decrease. According to our estimations, new construction is expected to reach 665,000 sq. m of warehouse space, which is 30% lower than our previous forecast of Q4 2019.

Speculative construction will be the first to shrink as it is the most sensitive segment for any market changes.

Over the past few years, online retail has been increasing its impact on the warehouse sector. Self-isolation and high-demand for online purchases made it obvious that the segment has issues with the scaling of business and turnaround time for orders. This will lead to increasing demand for warehouse space from retailers and will stimulate the development of urban logistics.

We see the growth of tenants' requests for short-term optimization of lease terms.

Many tenants have such requests, however, in many cases landlords prefer take time and wait.

ON RADAR: WAREHOUSE

Pandemic effect will not change basic trends in the warehouse segment.

Short-term forecast

- The growth of tenants' requests for temporary optimization of lease terms.
- Redevelopment of supply chains by several tenants.
- Slowdown of speculative construction.

Mid-term forecast

- Demand decreasing. Estimation of take-up will be possible closer to the 2nd half year.
- Localization of production – an increase in the share of construction of manufacturing sites and factories within industrial parks and free economic zones of Russia («import substitution 2.0»).

KEY TRENDS

Landlords and tenants will have two options to solve the requests for temporary optimization of lease terms: renegotiate lease terms at the moment or keep waiting for clearer understanding of the market recovery timeline.

Hospitality & Tourism

SEGMENT IS PARALYZED. DEMAND RECOVERY IS EXPECTED IN Q3-4 2020. FULL RECOVERY WILL TAKE 3-5 YEARS

CURRENT SITUATION

Starting from mid-March, hotel business across the country lives in crisis mode.

3-10%

Current occupancy

Capital and regional markets

0%

Current occupancy (complete shutdown on 28.03.20-01.06.20)

Resort markets

Hotel owners and managers

Capital cities. Demand – mostly, from long-stay guests and walk-ins (predominantly, domestic clients). No substantial change in room rates due to low price elasticity of the current demand. While some small private hotels stop functioning, there are no mass shutdowns of full-format hotels just yet, although some of them start reducing room inventory by closing guest room floors.

Resort locations. Following the ordinance issued by Prime Minister Mikhail Mishustin, all means of collective accommodation in resort locations will be temporary closed until 01.06.2020. Certain markets make exceptions for business hotels.

Regional markets. Individual temporary closings of hotels (due to decisions made by owners or following the ordinances issued by the regional authorities).

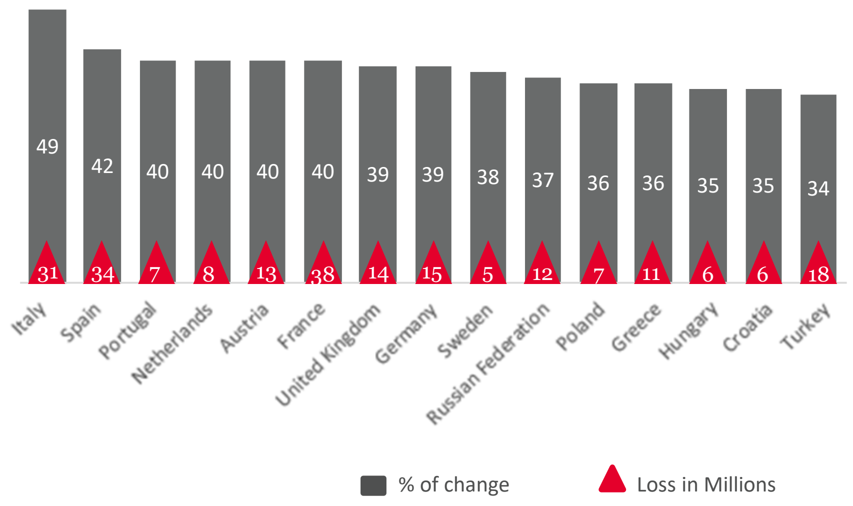
Actions of management/operators – sustain hotel operations in full or in part (due to inability to restructure staff numbers) until the end of the current self-isolation regime. A number of hotels offer to accommodate medical personnel in-between COVID-19 shifts or guests in a self-isolating regime. The possible negative effect of such measures may outweigh positive ones, as hotels do not have means to fully isolate potentially infected quests, which can cause virus spreading across numerous areas of a building (as happened on the Diamond Princess cruise liner). It may cause a massive negative effect for the image of the hotel thereafter.

Actions of owners – if regional authorities rule for a complete shutdown of collective means of accommodation – announce a downtime period (stoppage) for a hotel, hoping for partial compensation of costs by the state (it should be noted that state subsidies will be offered primarily to small and medium-size businesses). If regional authorities do not announce such downtime period – try to postpone or minimize payouts to hotel operators and suppliers (including OTA booking channels), at least, until June/July. For hotel projects scheduled to open in H1, 2020 – shift opening dates till later in the year.

FORECAST

Even if the self-isolation regime ends in late May/early June, full market recovery will take years, not months.

International travel: countries with the highest drop in in-bound volumes in 2020 (% and million visitors)



Source: Oxford Economics, 01.04.2020

Estimated Peak Week and return to Normal Week *(as of 6th April 2020)*

Region	Peak Weeks	Return to Normal
China*	Feb 11-18	Mar 31 - Apr 7
Italy	Apr 5-18	May 29 - June 5
US	Apr 15-29	June 17-24
Spain	Apr 3-17	May 22-29

* China used as timeline guide

Source: GlobalData, 2020

ON RADAR: HOTELS

Segment is highly sensitive to current economic downturn, recovery will not be quick.

GENERAL TRENDS:

Any expected recovery of occupancies will not mean simultaneous full recovery of revenues, as any growth of demand will be stimulated mainly by the price of the offer.

Once the current moratorium on staff restructuring and layoffs is over, the hotels may have to do just that - start restructuring and laying off their personnel, particularly in the markets most affected by the loss of business. “Price wars” may also be expected, as in the shrinking economy market players will be chasing the same clients.

If the current situation with minimal volumes of operating revenue together with owners’ obligations to pay salaries in full lasts longer than 2 months (until the end of May) - first bankruptcies are possible, instigating remaking of the market.

MARKETS:

Moscow – first signs of sales recovery may be seen in the summer thanks to domestic holiday-makers. A more substantial demand recovery may be registered in the fall, with return of business meetings and travel – assuming the global economy does not spiral into a full-scale recession. A quick recovery of foreign leisure travel (except for citizens of CIS countries, perhaps) is not expected, making domestic travel the main source of demand for Moscow hotels where modern quality hotels over the last years have been registering over 60% of domestic clients. Occupancies reaching and exceeding the normal levels (60% and more) are not expected until the beginning or mid-2021.

St. Petersburg – due to a high share of leisure demand, the quickly approaching ‘high season’ (May-August) which normally generates about 60% of annual revenues, is at risk. If it falls through, even with some domestic demand, business is not expected to recover before Q2, 2021.

Resorts – once the self-isolating regime ends, resort markets may rebound quickly (currently, Sochi resort hotels have more reservations on their books for June and thereafter than for the same period in 2019) with guests who traditionally spent their holidays overseas until this year.

Regional markets – since domestic demand forms the lion’s share (95% and above) of accommodation and conference & meetings business in the regional markets, once the Russian economy starts showing signs of improvement, hotel business may start recovering with the beginning of the business season in Sept 2020. However, full recovery of sales is hardly to be expected before 2021.

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