

Office Market Report Moscow. May 2015

Supply

In May, 2015, the overall market for quality office space in Moscow reached 17.9m sqm and amounted to 3.8m sqm (21%) of Class A offices and 14.0m sqm (79%) of Class B space.

The pace of new construction remained high. Despite the difficult economic situation, properties with a high readiness stage are being completed and brought to market. Over the period from January to May, 374K sqm of space was commissioned.

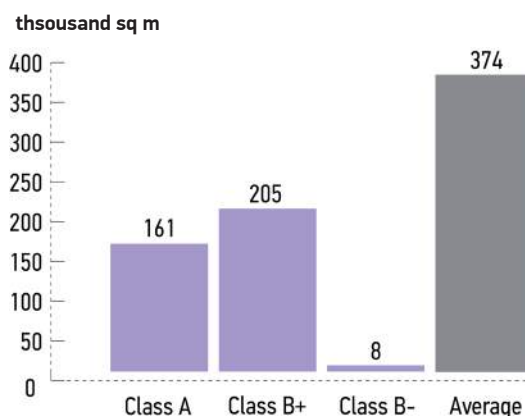
In first two months of the second quarter were commissioned such large objects as Business center «Pallau-RB» on Rublevo-Uspenskoe highway (office area of 46,5K sqm), building B of the Business Park «K2» (office area of 18,2K sqm), and also a new building on the territory of the «Sheremetyevskiy» Office

park (office area of 13K sqm). It should be noted that some areas in «Pallau-RB» and «K2» at the time of commissioning has been sold. In total for April and May 83K sqm were commissioned.

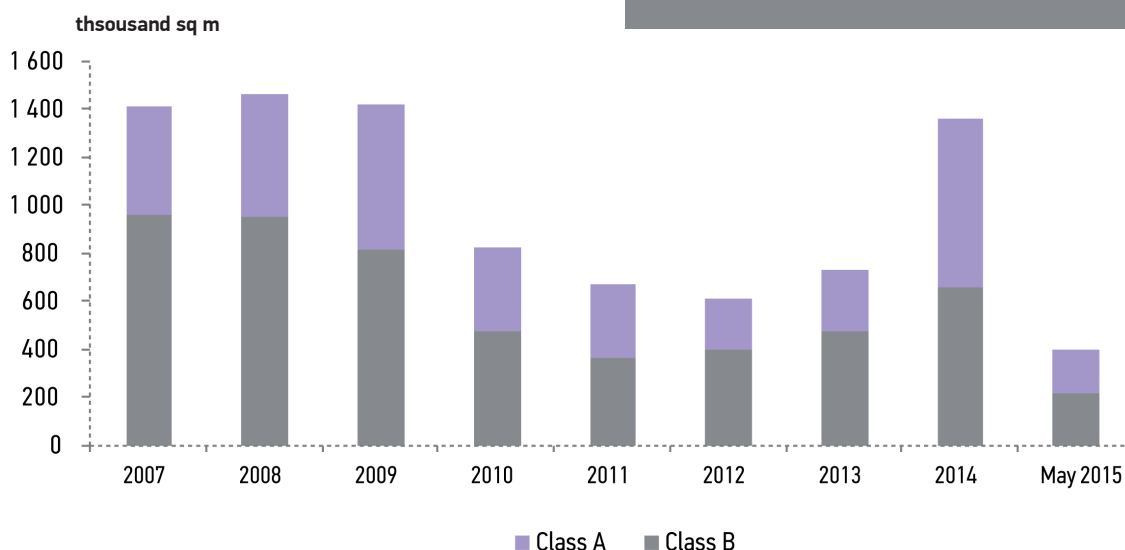
Therefore, in five months the total market for office space increased by 2.2% due to new construction. Growth in the Class A segment amounted to 4.4% while in Class B the increase was 1.6%.

Decentralized business districts have formed in the Moscow office market. This is reflected in the geographical distribution of new facilities: during the three months, only 12% of all new offered office space was launched in the CAD. The largest volumes are in the southwestern area (25%), in the Moscow City district (22%) and in the south administrative district (19%).

Increase in supply at the end of May 2015



Increase in supply



By the end of 2015, developers claim to deliver another 800Ksqm of high quality office space to the Moscow market. However, with the current

economic situation and the drop in demand, some of the listed construction will be moved to a later date.

The current trend of decentralization

of new facilities will only strengthen. Almost all the new construction (85%) will be located outside the CAD.

Major properties expected to be commissioned 2015

Property	Address	Developer	Class	Office area, sq m
IQ-kvartal	Presnenskaya emb. Moscow city 11	Hals-Development	A	108 623
Oruzheiny	Oruzheiny per. 41	Sadovoe Koltso	A	90 000
Simonov Plaza	Leninskaya Sloboda Str. 26	City&Malls PFM	B+	65 500
Bolshevik, phase Ib, II	Leningradsky pr-t 15, bld. 1	O1 Properties	A	61 700
Suvorov Plaza	Kutuzovsky pr-t 32	Stroygazconsulting	A	60 000
Neopolis	Kievskoe sh., 3 km from MKAD	A-Store Estates	A	52 700
Atlantic	Mozhaisky Val Str. vl. 8	Dallas Development & Construction	A	48 500
Otradny, phase II	Otradnaya Str. 2B	Motek-C	B+	45 400
Biznes-park G10, phase 1	Kievskoe sh., 0,5 km from MKAD	Comstrin	A	30 200
Oasis	Korovy Val Str. 3	BIN	A	28 775
Algoritm	Akademika Pilyugina Str. 22	BIN	B+	28 713
Kuntsevo Plaza	Yartsevskaya Str. 19	Enka	A	28 110
Novator	Khimki, Kirova Str.	MDK Group	B+	24 000
Krylatsky Hills, bld. 5	Krylatskaya Str. 19	CMI Development	B+	21 900

Demand

In the beginning of the year, which is traditionally the least active period, demand continued to show a downward trend influenced by negative macroeconomic factors. In 2014, we observed a reduction in demand caused by the economic crisis and the desire of companies to reduce their costs. In the spring of 2015, against the backdrop of continued uncertainty, the mood of tenants is still determined by the economic and political situation in the country.

Over the five months, the total volume of net absorption which shows the change in occupied office space has fallen to a negative value of -116K sqm.

The negative value of net absorption is primarily due to vacancies in Class B+ and

B- facilities. The following values were reached here: -73K sqm for each class. In our view, this suggests that companies leasing space in buildings of this class were the most vulnerable to economic instability and in order to cut costs, in most cases, they concluded lease agreements reducing occupied space.

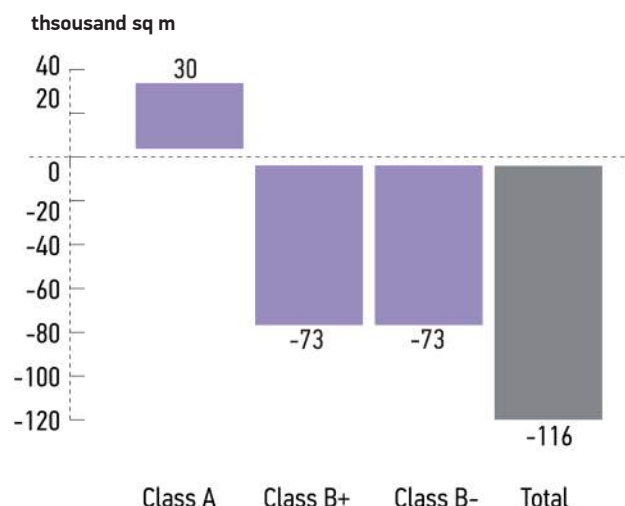
In addition, against the backdrop of oversupply and high competition between property owners in the market, new opportunities have opened up for tenants to lease high-quality facilities on attractive commercial terms. In order to secure comfortable conditions, companies move to facilities of better quality and vacate previously occupied offices.

This is evidenced by the value of net

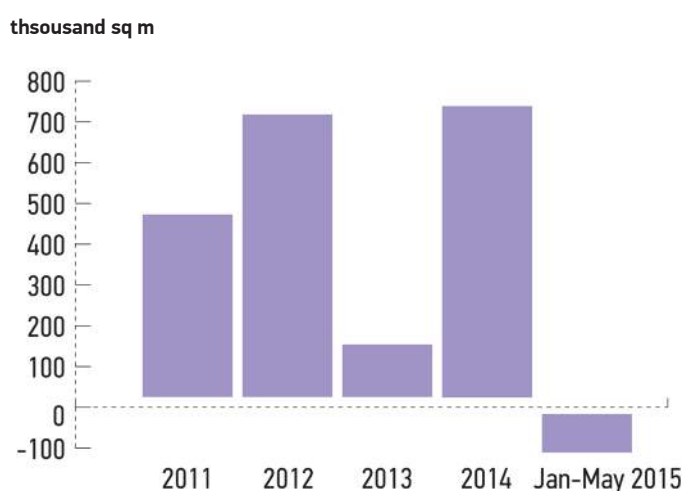
absorption in Class A properties which was the highest of all classes in the results of May, namely 30K sqm.

It is worth noting that the positive index results were achieved due to increased demand for Class A premises specifically in the 1st quarter of 2015. If we talk about the period of April-May, there was, on the contrary, a small release of areas and indicator reached a negative index, reducing the volume of the offices occupied by tenants in class A buildings for 1K sqm at the end of May. In the class B there is a reverse situation. Despite the fact that over the past two months, the volume of net absorption was negative again, the release of spaces in such facilities has decreased.

Net absorption, Jan-May 2015*



Net absorption trend



**Net absorption show changes in the absorption of office space tenants for a certain period.*

Net absorption is calculated as: $S1 + S_{new} - S$, where

S1 – vacant office premises at the beginning of the given period, S_{new} – new supply of office premises for the given period, S2 – vacant office premises at the end of the given period.

Thus, the interest of companies is now directed at properties whose owners are ready to make accommodations to tenants by quoting rates in rubles or offering exchange rate corridors as well as rent-free periods, furnishing of the space or compensation for such furnishing.

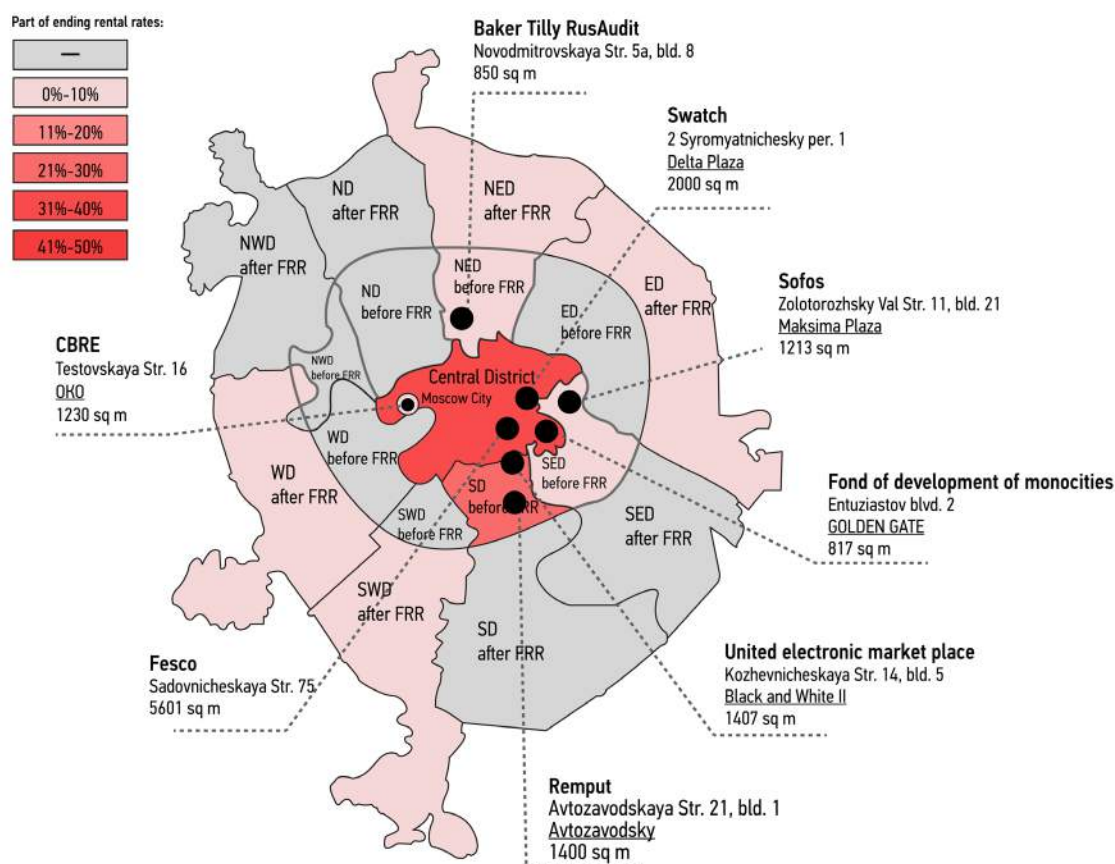
In the context of economic uncertainty, many tenants prefer to renew their lease in the current building seeking to reduce their rental costs and to review the terms and conditions. In Q1 2015, we continued to observe an

increase in the number of transactions in which the company remained in the leased office but on terms that were more attractive.

Despite the fact that more and more companies in order to reduce costs consider the placement of their offices outside of the central district, the greatest demand from tenants is still for the facilities in the city center. Against the backdrop of a highly competitive facilities and reduction of rental rates, companies achieve comfort rent conditions for such premises. Thus,

to date the largest proportion (42%) in the total number of transactions on office lease accounts for offices in the central district. Also a high proportion of transactions, namely 23%, is observed in the vicinity of the south administrative district (SAD) before the Fourth Transport Ring (FTR). It is worth noting grown share of transactions in the areas remote from the center. This supports the process of market decentralization, when companies, trying to save money on office rent, choose high-quality objects at lower rates.

The distribution of the total number of transactions in Moscow districts and the largest transactions in the market in 2015



Vacancies

The amount of vacant office space began to increase starting in mid-2014 and in May 2015 averaged 17.8% in Moscow. Negative net absorption and significant excess of new construction resulted in the vacancy rate in the first three months of the year growing by 2.3 pp. Currently, more than 3,1m sqm of office space are vacant of which 1,1m square Class A properties.

In spring of 2015, the number of listed properties again reached a record high for the Moscow office real estate market exceeding the values for the 2008-2009 crisis.

The highest vacancy rate remains in Class A buildings. In the five months it grew by 2.9 pp and in late May reached 29.1%. It is

worth noting the increase of listed properties in such facilities due to the availability of a significant amount of quality office space offered for sublease.

As a result of the introduction of a large amount of new supply as well as the vacating of office units caused by the reduction in occupied space and relocation of companies, the vacancy rate in Class B+ increased by 3.4 pp over the five months and reached 20.6%.

At the same time, changes in the vacancy rate in Class B- facilities were less obvious. As of the end of May, the vacancy rate in these buildings was 8.5% which is 0.5 pp more than in the previous quarter.

Vacancy rates, at the end of May 2015



Vacancy rate trend



Rents

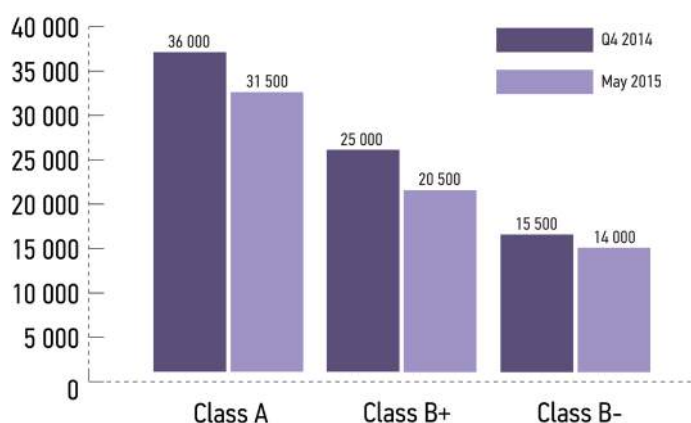
In spring 2015, we continued to observe a downward trend in average rental rates. This was due to internal processes occurring in the market as well as macroeconomic instability and a decline in demand during the economic crisis.

Today, the market is moving towards

ruble rates. In order to attract tenants and minimize the amount of vacant space in their facilities, owners have to adapt to new conditions. More and more landlords quote rental rates in rubles or move to standard units by adopting a fixed exchange rate or an exchange rate

corridor. Under these conditions, there has been a decrease in asking rent rates in ruble terms; property owners are adjusting their business terms attempting to meet the expectations of tenants.

Average base rental rates, in rubles



The decline in average asking rental rates in Russian currency also occurred in Class A where rates are traditionally quoted in US dollars. This is due to the fact that a large number of owners are gradually moving to ruble contracts. During five months, the average base asking rental rates for Class A space dropped by 12.5% and by the end of May was 31,500 rubles per sqm per year.

Also worth noting is the current significant difference between the asking price and the real value of transactions. Even in cases where the owners quote rates in US dollars and are not willing to reduce the listed rental rates in primary offers, tenants may negotiate rental terms obtaining a discount of up to 30-40% off the original rates.

Dynamics of average base rental rates, at the end of period

