

Office Market Report

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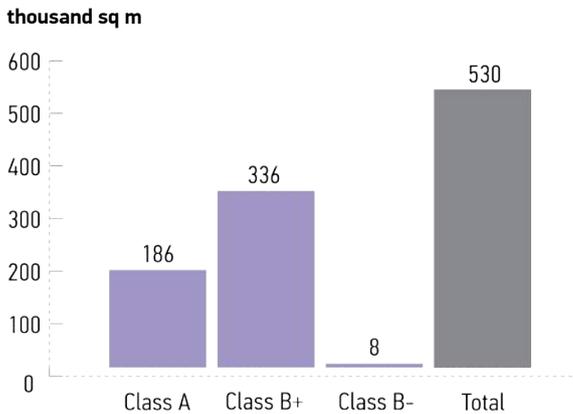


real estate intelligence

3M MOSCOW
Q. 2015

Main Indicators, Q3 2015

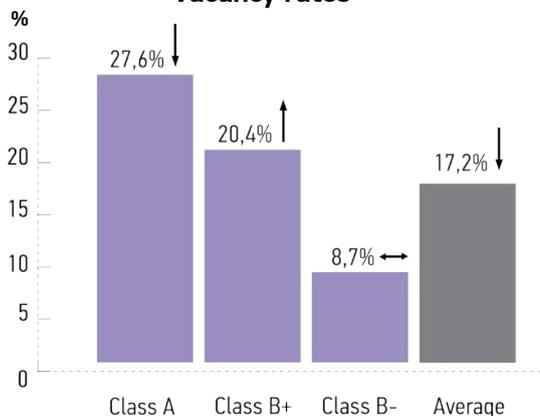
Increase in supply in Q1-Q3 2015



Net absorption, Q1-Q3 2015



Vacancy rates*



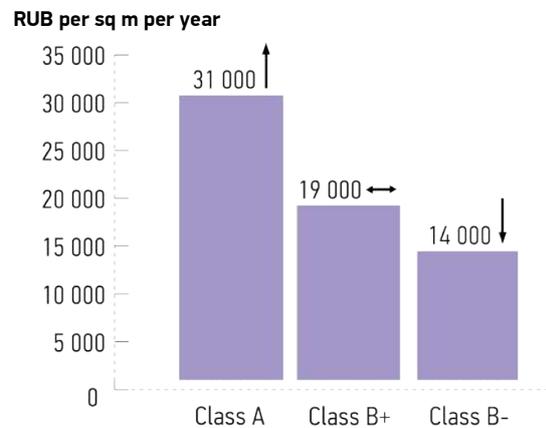
*Comparing to the end of Q2 2015



Dmitry Myslin
Manager Partner

Growth in office jobs is still a long way away. As a result, there are no visible drivers to increase net absorption across the market. We only see ongoing migration towards higher quality from expensive, low grade, or awkwardly-located over to inexpensive and high grade. And this process will continue until the vacancy rate in the Class A and B+ sectors outside the Moscow Ring Road drops to equilibrium values – those closer to 10%.

Average base rental rates, in rubles*



Rental rates excluding VAT (18%) and Operation Expenses

- ▶ The pace of new construction continues to decline, and the commissioning dates of more and more properties have been rescheduled for later periods. From January to October, 530K sq. m of spaces were brought to the market, which is 45% less than during the same period last year.
- ▶ Over the last three months, net absorption grew by 76K sq. m, thus rising up and out of the negative zone. Increased absorption in upscale facilities and vacation of spaces in Class B- indicate a continuing trend towards improvement of the quality of spaces occupied.
- ▶ At the moment, around 3.2m sq. m of office spaces are vacant, i.e. one out of every six square meters on the market today remains vacant. However, increased absorption and reduced commissioning of new properties in the third quarter contained growth of vacant spaces.
- ▶ The average rental rates for quality office space have remained in decline. Owners continue to adjust the rental prices to the level of effective demand. Despite the fact that the average dollar rental rates decreased across all classes, in rubles the trends vary.



Andrey Lukashev
Manager Partner

A large share of vacant spaces is being offered in shell and core condition. Demand for shell and core spaces is at present extremely low, and many owners are willing to provide a turnkey finish based on the tenant's requirements and also divide the spaces into smaller units. Accordingly, the following quarters will witness an even greater trend towards the migration of companies into new top grade Class A and B+ offices.

Supply

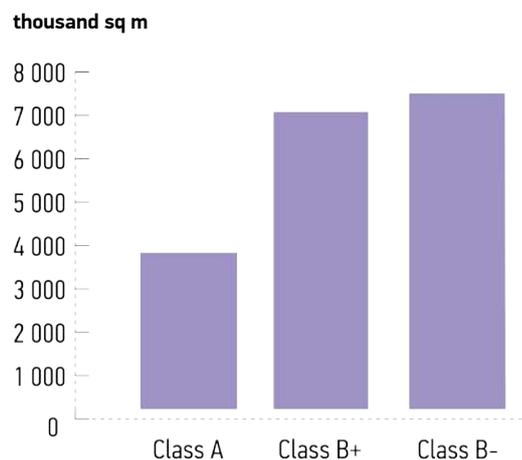
In Q3 2015, the overall market of top grade office spaces in Moscow reached 18.5m sq. m, of which 3.9m sq. m (21%) are Class A properties, and 14.6m sq. m are Class B (79%).

The pace of new construction continues to decline, and the commissioning dates of more and more properties have been rescheduled for later periods. From January to October, 530K sq. m of spaces were brought to the market, which is 45% less than during the same period last year. As compared with 2014, the growth breakdown into property classes has also changed. Whereas last year, the share of Class A build-

ings was prevalent among newly built properties, in 2015, approximately 63% of all the spaces commissioned across all three quarters belonged to Class B+.

Decentralization of new construction continues to develop business districts away from the city center. In the 3 quarters, only 9% of the total commissioned properties were located in Central Administrative District. The leaders were South Administrative District and South-Western Administrative District, where the total floor areas of newly commissioned office spaces were 162K sq. m and 124K sq. m, accordingly.

Total stock, Q3 2015



Increase in supply



Major properties commissioned in Q3 2015*

Office building	Address	Developer	Class	Office area, sq m
Simonov Plaza	Leninskaya Sloboda Str. 26	City&Malls PFM	B+	65 500
Algoritm	Akademika Pilyugina Str. 22	BIN	A	28 713
Danilov Plaza	Novodanilovskaya emb. 6	MR Group	B+	13 539

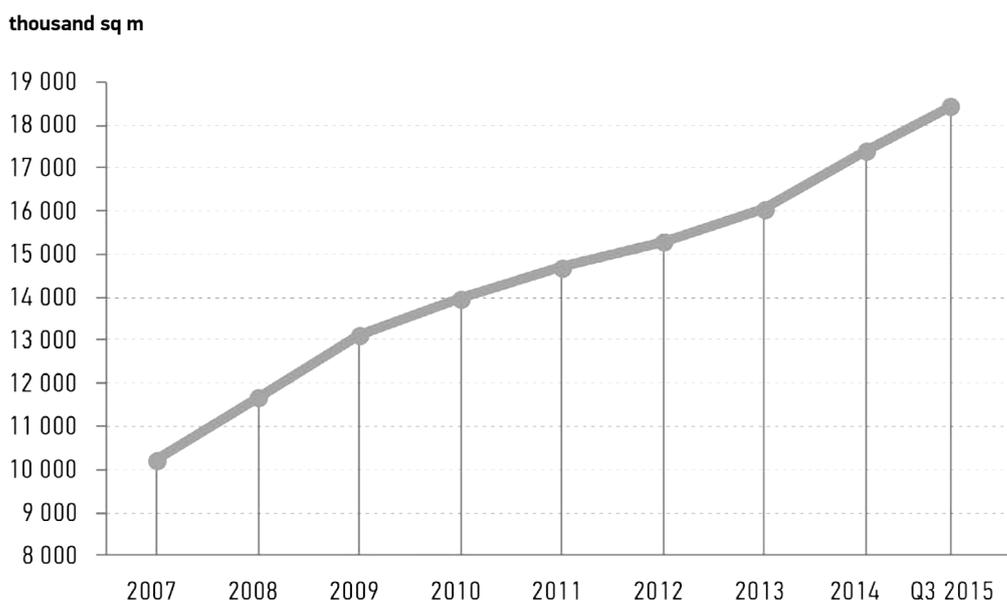
*Buildings which were commissioned as well as those which reconstruction will be completed in Q3 2015

Only 110K sq. m of new office spaces were commissioned in Q3, which is the lowest value over the past two years. This decline in construction activity was a result of reduced demand amid the large amount of spaces commissioned in 2014, which the market was not able to absorb.

During the past three months, four office properties were brought to the market, all in SAD and SWAD. The largest was the Simonov Plaza Business Center, part of the Simonovskiy Business Quarter (office area of 65,500 sq. m) and the Algoritm Business Center (office area of 28,700 sq. m).

Over the three quarters, the total market for office spaces increased by 2.9%, due to new construction. In the Class A segment, growth amounted to 5.0%, while in Class B, the increase was 2.4%.

Total stock trend



Over the three quarters, the total market for office spaces increased by 2.9%, due to new construction. In the Class A segment, growth amounted to 5.0%, while in Class B, the increase was 2.4%.

By the end of 2015, developers will have scheduled the commissioning of another 400K sq.m. In the current en-

vironment, however, when construction deadlines are being extended, we estimate that these results will not be achieved. Most likely, not more than 200K sq. m of office spaces will have been built prior to the end of the year. Thus, the total amount of office spaces commissioned by the end of Q4 will be about 700K-730K sq. m, which is half as

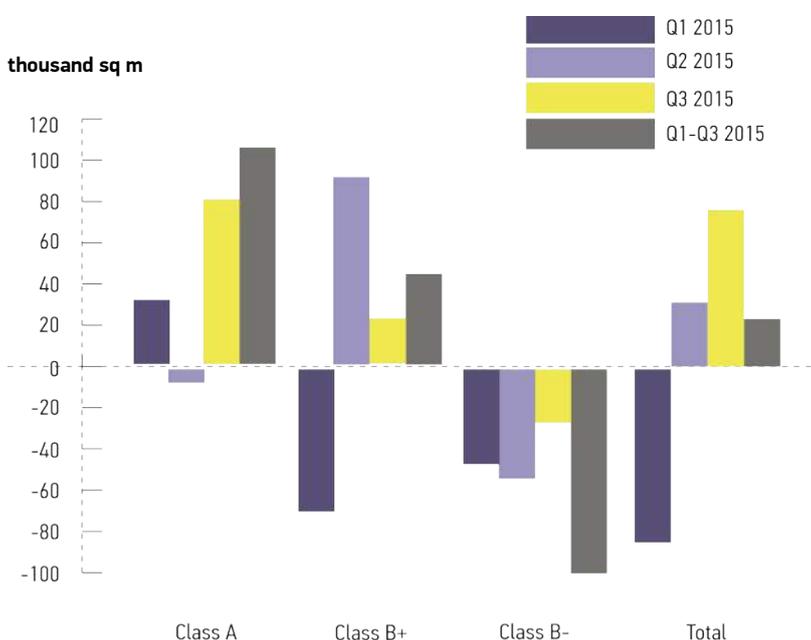
much as last year. It is also worth noting that construction operations on many sites in the initial stages have been suspended due to a lack of funding. This can lead to a decrease in the growth rate of new spaces over the next 3 years, when commissioning may be at a minimum.

Major properties expected to be commissioned in 2015

Property	Address	Developer	Class	Office area, sq m
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
Nagatino i-Land, ph. II, Dekart	Andropova pr-t 18	Moscow business incubator	B+	31 000
Kuntsevo Plaza	Yartsevskaya Str. 19	Enka	A	28 110
Bolshevik, ph. Ib	Leningradsky pr-t 15, bld. 1	O1 Properties	A	19 700

Demand

Net absorption, Q1-Q3 2015*

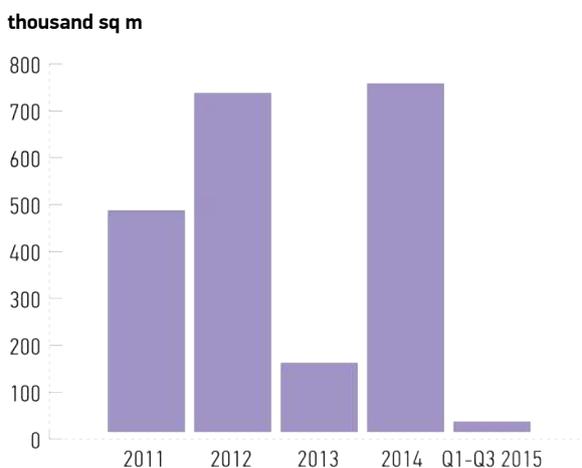


Over the last three months, net absorption, an indicator linked to changes in office spaces held by tenants, grew by 76K sq. m, thus rising up and out of the negative zone. Despite the positive momentum, however, tenant demand for new spaces is still estimated as weak. Over the three quarters, total net absorption amounted to 23K sq. m compared to 560K sq. m during the same period last year.

The increase in total space occupied during this period was achieved primarily due to increased demand for additional office spaces in top grade facilities. In Q3 2015, net absorption in Class A properties amounted to 80K sq. m, which is 86.5K sq. m higher than the relevant figure of the previous quarter, when its value was negative. And the nine month total in properties of this class was 105K sq. m.

Vacation of spaces in Class B- continues; over the nine months this value reached -125K sq. m. However, the vacation rate has decreased – in Q3 net absorption totaled -26K sq. m compared to -53K sq. m in Q2.

Net absorption trend

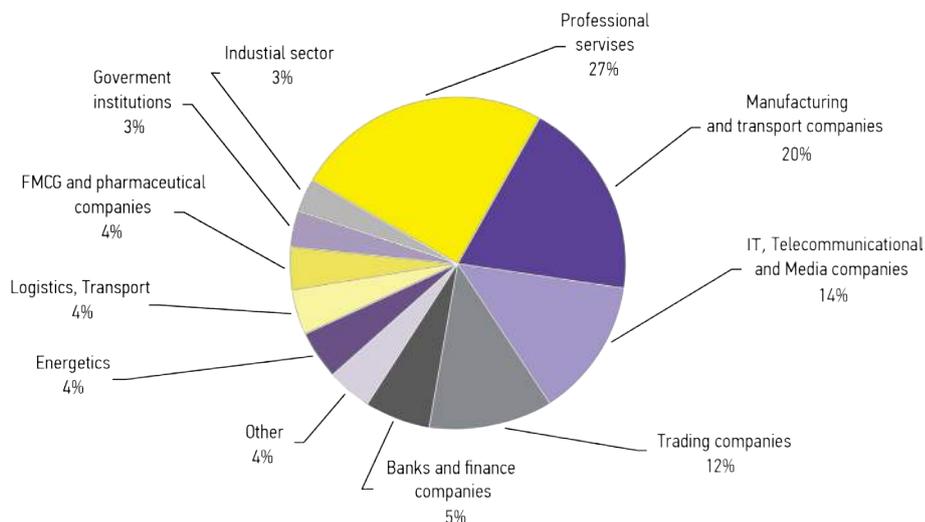


*Net absorption show changes in the absorption of office space tenants for a certain period. Net absorption is calculated as: $S1 + Shew - S$, where $S1$ - vacant office premises at the beginning of the given period, Sw - new supply of office premises for the given period, $S2$ - vacant office premises at the end of the given period.

Increased absorption in upscale facilities and vacation of spaces in Class B- indicate a continuing trend towards improvement of the quality of spaces occupied. Against the background of high vacancy and reduced rental rates, companies are relocating to top grade facilities on terms that are more attractive, leaving lower class offices vacant. Given the huge amount of vacant spaces in Class A properties, as well as the sharp rise in the relative value of property tax, compared with the low rates in Class B, the trend towards transition to Class A will only intensify in the years to come.

A significant share in the current market is still being held by lease renegotiation transactions. In the face of economic uncertainty, companies continue to optimize their costs and seek to renegotiate lease terms in accordance with the current market situation. However, the bulk of the lease renegotiation transactions arrived at the beginning of the year; over the recent period, the number of such transactions has dropped.

The structure of demand according to the branch of business activity, Q3 2015



The analysis is based on the total number of applications received by ILM by the represented business Q1-Q3 2015

Key deals in Q3 2015

Company	Area, sq m	Type of deal	Property	Address
Yamal-LNG*	20 400	lease	Algoritm	Akademika Pilyugina Str. 22
Adidas	20 000	lease	Krylatsky Hills, bld. 5	Krylatskaya Str. 19
Gloria Jeans	3 600	lease	Arma zavod, bld. 3	Nizhny Susalny per. 5
Roszheldorproject	3 540	lease	Krasnoselsky	Verkhnyaya Krasnoselskaya Str. 3
Rosenergoatom*	3 157	lease	Newton Plaza	1 Nagatinsky pr-d 10, bld. 1
Norilsk Nickel/ NN-Infocom*	2 022	lease	Naberezhnaya Tower, block C	Presnenskaya emb. 10
Spetsstroy service of Spetsstroy of Russia	2 000	lease	Donskaya Str. 15	Donskaya Str. 15
Bio-Rad	1 600	lease	Arma 4-5	Nizhny Susalny per. 5
Squire Patton Boggs	1 300	lease	Romanov Dvor III	Romanov per. 4
FNK-Group*	1 255	lease	Central City Tower, phase I	Ovchinnikovskaya emb. 20/1
Energy Consulting	1 000	lease	Kvartal-City	Dubinskaya Str. 53
Artec Group	1 000	lease	Bol. Levshinsky per. 6/2, bld. 1	Bol. Levshinsky per. 6/2, bld. 1

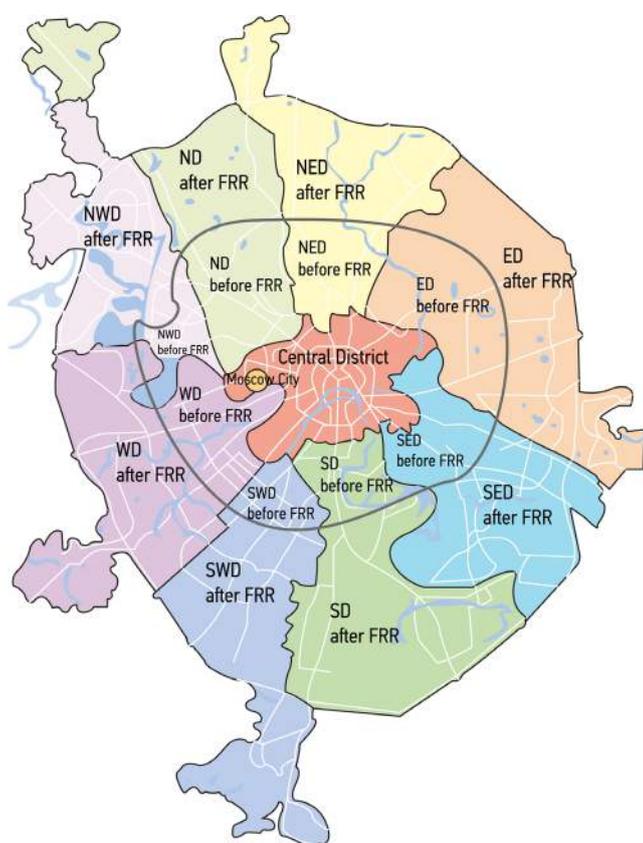
* ILM acted as a consultant of the transaction

Considering the distribution of demand by sectors of office space users, it is obvious that the internal structure has hardly changed, if compared with the first half of the year. The primary consumers of quality office spaces remain services companies. They account for approximately 27% of all

the queries, this being 1 pp more than during the same period last year. The number of inquiries from companies of the manufacturing sector has increased by 2 pp over the quarter, up to 20%. IT companies continue demonstrating a steady demand. At the end of September, the number of inquiries

from such companies came to 14%. Companies in the financial sector, which traditionally demonstrate high activity, are remaining cautious in the face of economic uncertainty. Over the course of the year, the figure dropped by half, and at the end of Q3, amounted to 5% of all inquiries.

Net absorption in various Moscow districts at the end of Q3 2015



District	Class A	Class B+	Class B-
Central District	-69,2	-29,6	-39,8
Moscow-City	129,7	-1,6	-*
NED before FRR	-0,8	-3,9	1,5
NED after FRR	-*	-3,8	-17,8
ED before FRR	8,2	-20,9	4
ED after FRR	-*	0,1	-1,9
SED before FRR	1,2	-6,3	10,6
SED after FRR	-*	0,1	4,3
SD before FRR	2,1	34,5	-12,3
SD after FRR	-*	-7	-19,8
SWD before FRR	0	3,4	-1,5
SWD after FRR	13,1	67,6	-10,1
WD before FRR	-42,6	-13,2	-6
WD after FRR	51,3	-24,5	-9,3
NWD before FRR	-*	-*	0,1
NWD after FRR	1,8	30,5	-7,3
ND before FRR	8	-1	-18,2
ND after FRR	2,2	7,4	-2,4

*Buildings not applicable in the indicated district
**FRR - Fourth Ring Road

Vacancies

Despite the fact that the pace of new construction has decreased, it is still greater than the needs of tenants in additional spaces. Low total net absorption only exacerbates the situation in the market, resulting in oversupply. At the moment, around 3.2m sq. m of office spaces are vacant, i.e. one out of every six square meters on the market today remains vacant.

However, increased absorption and reduced commissioning of new properties in the third quarter contained growth of vacant spaces. At the end of September, this figure amounted to 17.2%, which is 0.2 pp lower than during the previous quarter.

The vacancy momentum still differs depending on the class of spaces.

Following the growth of available space in Class A properties recorded in Q2, during Q3, the rate was adjusted and decreased to the level of Q1. Thus, at the end of September, the vacancy rate in Class A properties amounted to 27.6%. Reduction of vacancies over the past three months amounted to 2.1 pp, due to a number of major transactions, as well as transactions under negotiation, with the spaces in question not currently being offered on the market.

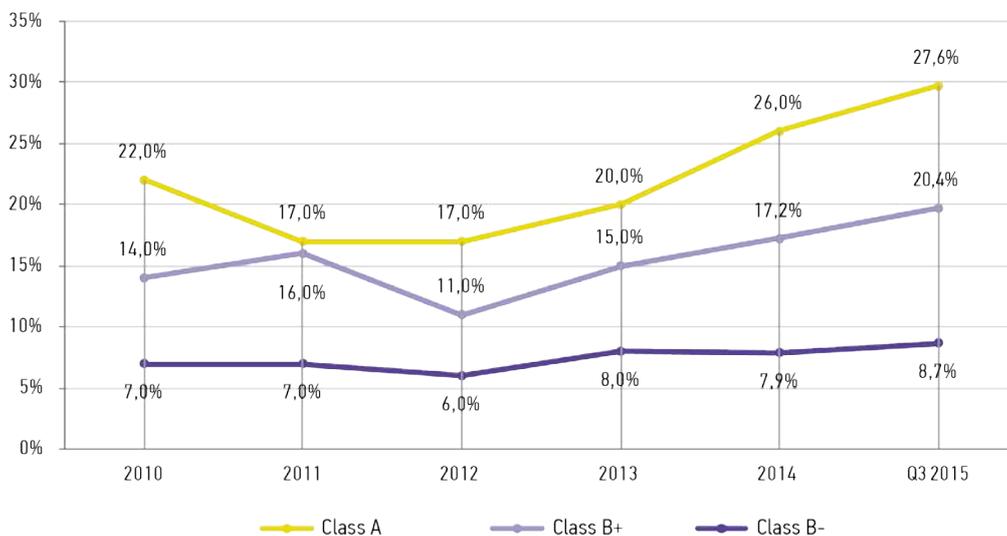
As of the end of Q3, a slight increase in the number of vacant spaces was observed in Class B+ properties:

by 0.7 pp, up to 20.4%. This was due to the commissioning of new properties of this class in Q3.

In the Class B- segment, the relative figure remained unchanged over the last three months.

The vacancy rate in the Class A segment is almost twice as high as that in Class B, although in absolute terms the situation is exactly the opposite. As of late September, 1.1m sq. m in Class A properties were being offered for rent and for sale, which is half as much as the total area of vacant spaces in Class B.

Vacancy rate trend



In terms of vacant Class A offices, the leading position is still held by in the 'WAD before the FRR' (95.7%) and 'NWAD after the FRR' (63.4%) areas (FRR stands for 'Fourth Ring Road').

The vacancy rate is still high in Moscow City: as of late September, the total area of vacant offices stood at more than 320K sq. m. However, due to the increase in net absorption, the vacancy rate dropped by 8.5 pp over the quarter,

coming to 34.4%.

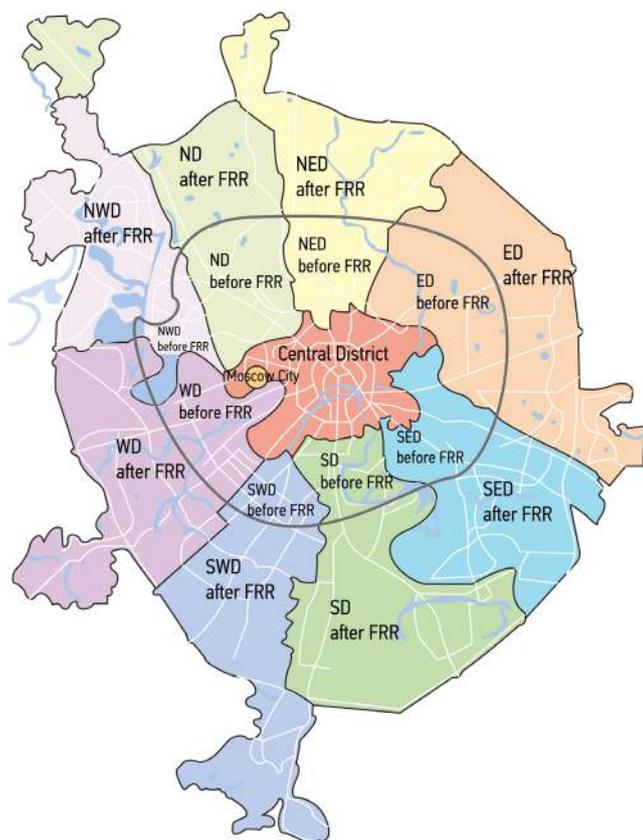
It is also worth noting the decline in vacant spaces in facilities located in the 'SAD before the FRR' and 'WAD before the FRR' areas. Due to transactions concluded in these areas throughout the quarter, the relevant figures dropped by half.

In CAD, the vacancy rate in Class A facilities grew by 2.7 pp, up to 21.1%. In Class B, the indicator remained un-

changed over the past three months and came to 10.2%.

In the next year or two, new business centers located outside the Moscow Ring Road away from the Metro will remain half-empty. And former industrial zones distant from the Metro that once underwent low-quality redevelopment will continue losing their tenants.

Vacancy rate in various Moscow districts at the end of Q3 2015



District	Class A	Class B
Central District	21,1%	10,2%
Moscow-City	34,4%	12,6%
NED before FRR	3,1%	15,2%
NED after FRR	-*	22,0%
ED before FRR	43,5%	10,8%
ED after FRR	-*	4,8%
SED before FRR	47,9%	13,3%
SED after FRR	-*	7,4%
SD before FRR	9,9%	17,3%
SD after FRR	-*	22,9%
SWD before FRR	46,1%	10,5%
SWD after FRR	32,1%	15,5%
WD before FRR	95,7%	32,9%
WD after FRR	10,5%	23,3%
NWD before FRR	-*	3,0%
NWD after FRR	63,4%	17,3%
ND before FRR	12,2%	9,9%
ND after FRR	32,9%	8,8%

*Buildings not applicable in the indicated district
**FRR - Fourth Ring Road

Rental rates



The average rental rates for quality office space have remained in decline. Owners continue to adjust the rental prices to the level of effective demand.

Over Q3, the average asking rental rates for Class A offices in dollar terms fell by 10% when compared with the previous quarter, down to \$470 per sq. m per year. In the Class B+ segment, rental rates were adjusted by 17%, dropping to \$285 per sq. m per year.

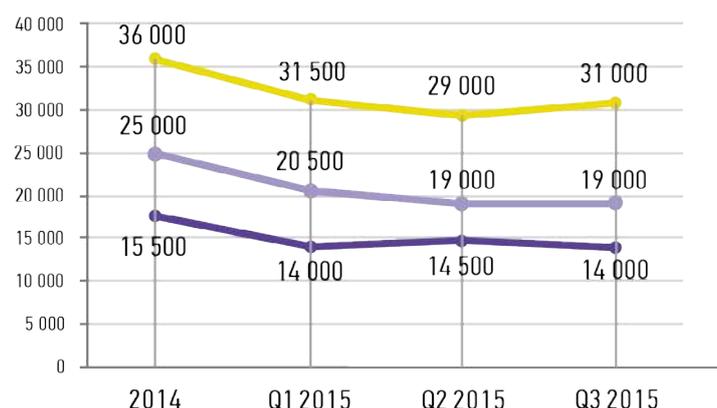
Despite the fact that the average dollar rental rates decreased across all classes, in rubles the trends vary.

In the Class A segment where properties with dollar rates are prevalent, by the end of Q3, the average rental rates grew by 6.5% under the impact of the weak ruble, rising to 31,000 RUB per sq. m per year.

In Class B+, the asking base rental rates in rubles remained unchanged over the last three months and stood at 19,000 RUB per sq. m per year. In Class B- where the owners switched over completely to ruble rates, the decline was 3.5%, and by the end of Q3 the average asking rental rate reached 14,000 RUB per sq. m per year.

Average base rental rates, in rubles

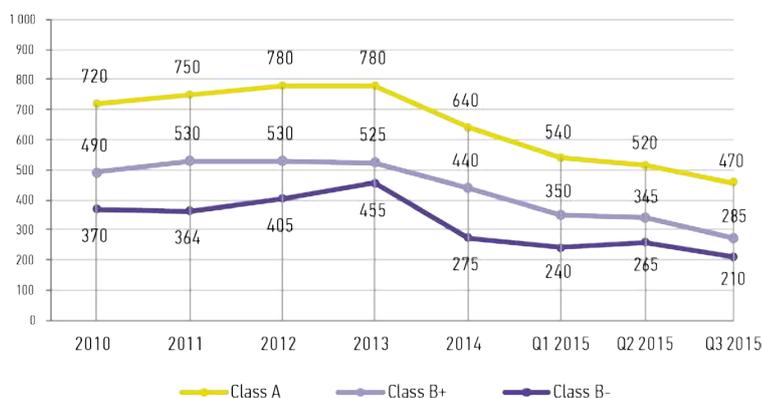
RUB per sq m per year



Rental rates excluding VAT (18%) and Operation Expenses

Dynamics of average base rental rates, at the end of th quarter

\$ per sq m per year



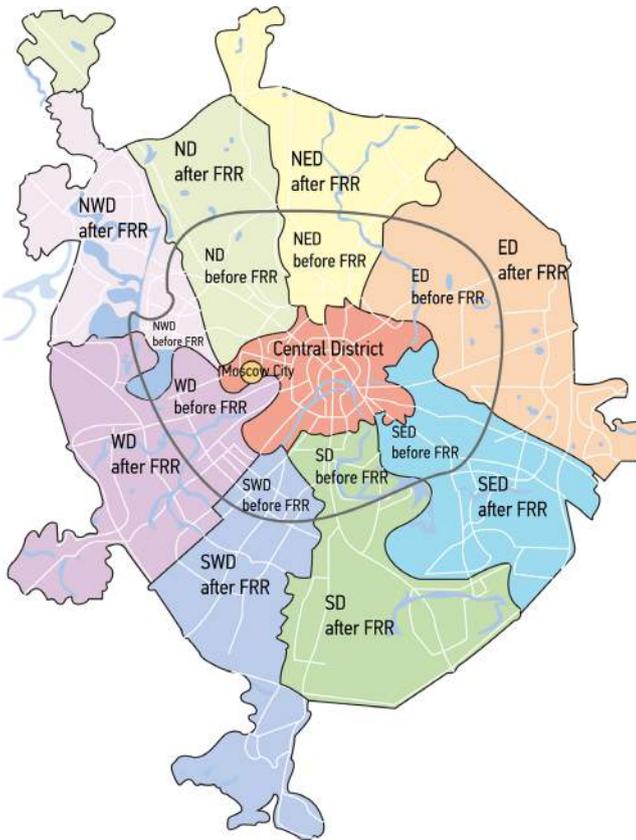
Rental rates excluding VAT (18%) and Operation Expenses

Conclusion of lease contracts in ruble terms remains the main trend in today's market. Given the current economic situation, significant numbers of owners are trying to minimize the share

of vacant spaces, make concessions to tenants by quoting rental rates in rubles or by fixing the exchange rate. However, most Class A owners are not ready for a radical change in the busi-

ness terms of long term rentals and prefer contracts with the exchanged rate fixed for one or two years.

Average base rental rates in various Moscow districts at the end of Q3 2015



District	Class A	Class B+	Class B-
Central District	45 500 RUB	26 500 RUB	16 700 RUB
Moscow-City	30 200 RUB	28 800 RUB	-*
NED before FRR	-*	13 600 RUB	12 300 RUB
NED after FRR	-*	8 900 RUB	10 800 RUB
ED before FRR	19 000 RUB	15 800 RUB	11 900 RUB
ED after FRR	-*	14 000 RUB	11 100 RUB
SED before FRR	24 100 RUB	14 200 RUB	10 700 RUB
SED after FRR	-*	14 400 RUB	13 100 RUB
SD before FRR	45 000 RUB	17 900 RUB	12 800 RUB
SD after FRR	-*	11 400 RUB	10 300 RUB
SWD before FRR	20 200 RUB	36 600 RUB	15 200 RUB
SWD after FRR	22 300 RUB	20 300 RUB	14 200 RUB
WD before FRR	23 200 RUB	22 400 RUB	15 700 RUB
WD after FRR	19 500 RUB	13 600 RUB	9 000 RUB
NWD before FRR	-*	-*	14 000 RUB
NWD after FRR	11 900 RUB	14 900 RUB	16 400 RUB
ND before FRR	39 100 RUB	19 300 RUB	13 600 RUB
ND after FRR	19 400 RUB	11 000 RUB	10 700 RUB

Rental rates excluding VAT (18%) and Operation Expenses.

*Buildings not applicable in the indicated district

**FRR - Fourth Ring Road

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