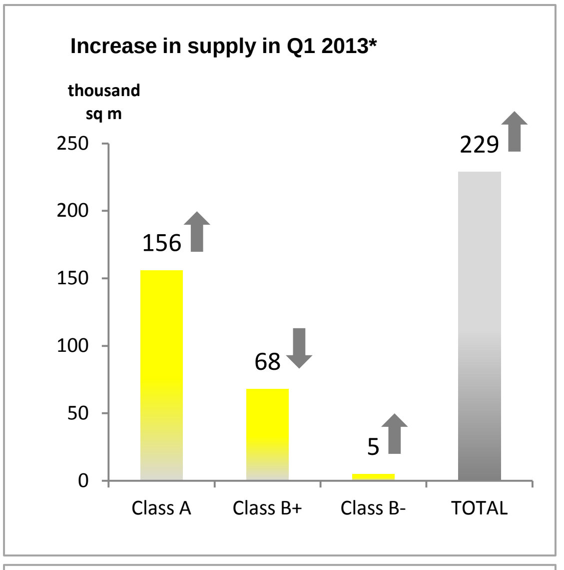
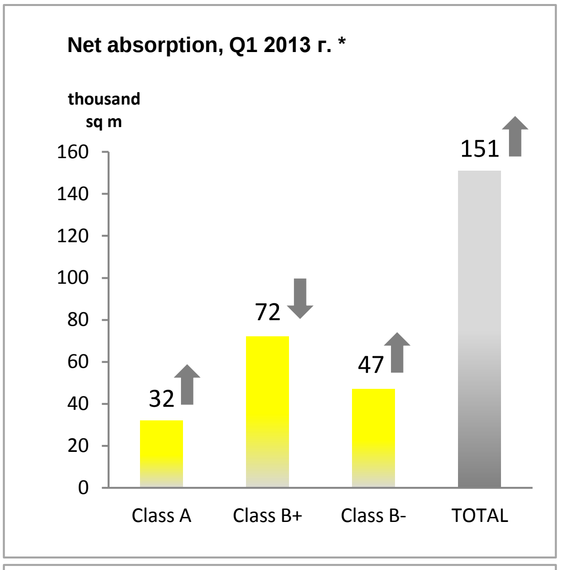
Moscow, Q1 2014

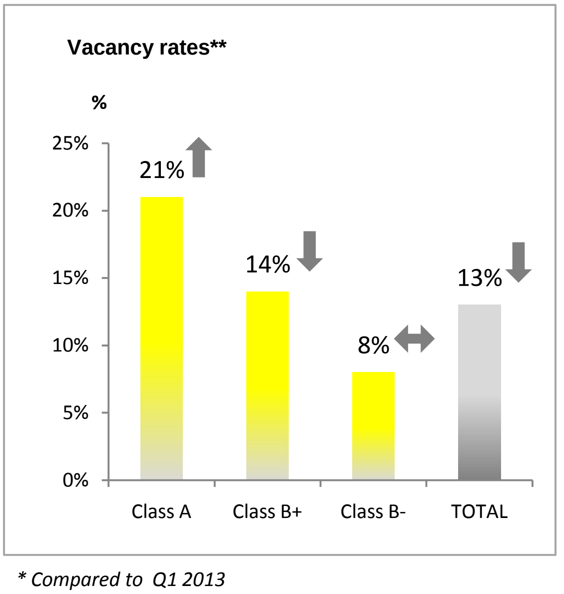
Office Market Report

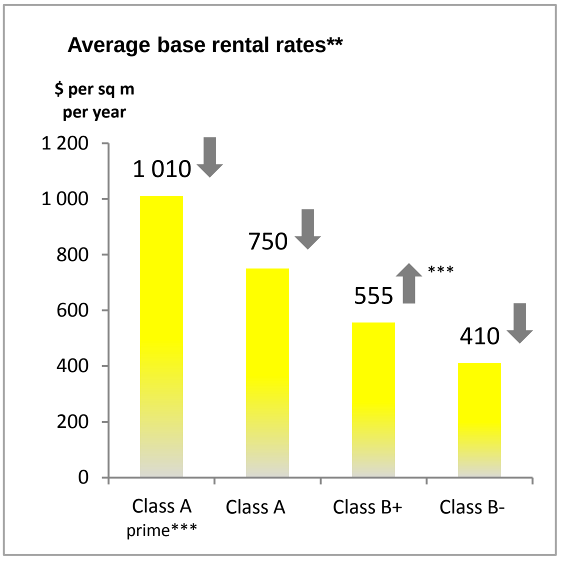
ILM
real estate intelligence

Main indicators, Q1 2014









** Compared to Q1 2013*
*** Compared to the end of 2013*
**** The increase in average Base Rental Rates in class B + office buildings is due to stringent requirements for class A office buildings in Moscow Research Forum classification of office buildings. In accordance with this renewed classification some of Class A office buildings moved from Class A to Class B+*
***** Class A office buildings within the Garden Ring*

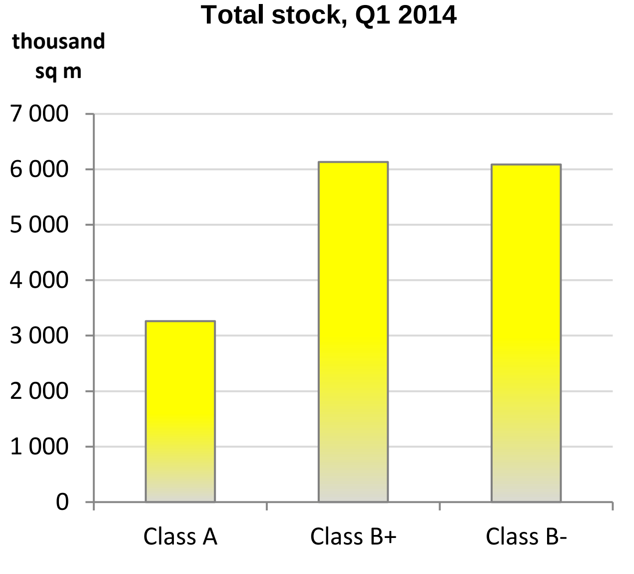
- In Q1 2014 the total volume of quality office space in Moscow reached 15,5 mln. sq. m. Within the first three months of 2014 299 thousand sq. m have been commissioned, which is 6 % more than at the same period last year.
- Net absorption of office space during the first three months remains low, but nevertheless it demonstrates a positive trend. Thus, the volume of net absorption increased by 8 times compared with the same period last year, and at the end of Q1 2014 it comprised 151 thousand sq. m.
- By the end of Q1 2014 vacancy rates reached 13,3%, which is 0,3% less than at the end of the previous year.
- The beginning of the year in Moscow office market, as in the country's economy and the world in general, was characterized by a fairly high level of uncertainty. This could not but affect rental rates and many landlords were forced to reduce rental rates to attract more tenants. Q1 2014 also demonstrated significant currency fluctuations . The average asking rental rates for Class A comprised $ 750 per sq. m per year, for class B + - $ 555 per sq. m per year., for Class B - average rental rates comprised $ 410 per sq. m per year .

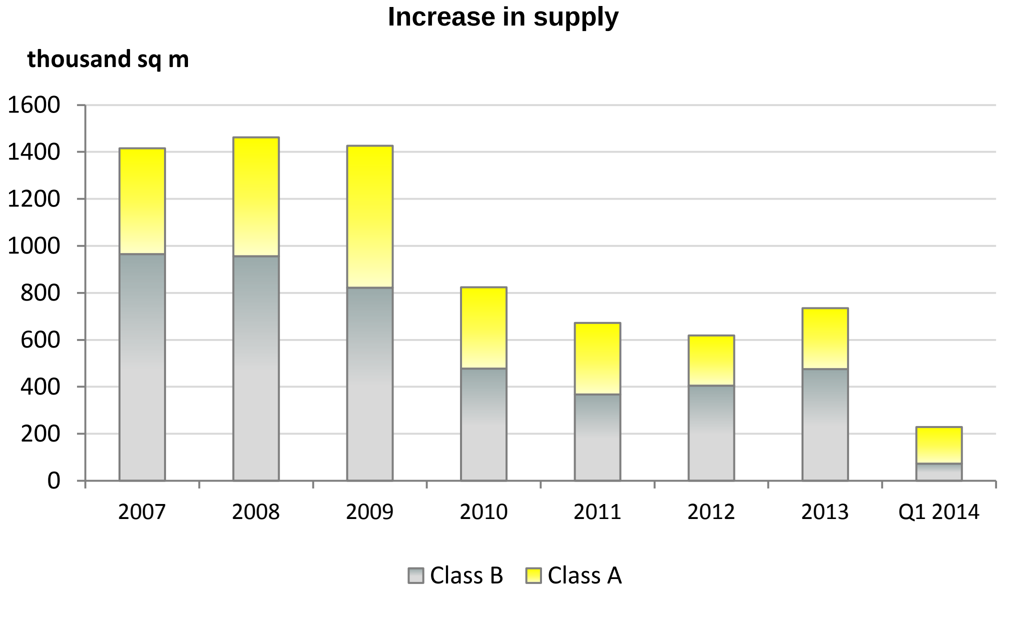
Supply

In Q1 2014 the total volume of quality office space supply n Moscow reached 15,5 million sq. m 20% of which are Class A and 80 % class B office buildings.

In 2013 Moscow Research Forum classification was renewed and class A office buildings requirements were tightened, office buildings that didn't meet new Class A office buildings' requirements were classified as class B+. Thus, the volume of class A office space supply in Q1 2014 decreased and amounted to 3.3 mln. sq. m.

Q1 2014 demonstrated a slight increase in the volume of new construction, within the first three months of 2014 299 thousand sq. m have been commissioned, which is 6 % more than at the same period last year.
Such positive dynamics is mainly explained by an increase in developers' activity and completion of the previously commenced office buildings which were under construction and which were postponed from 2013 to 2014.





68% of new office space supply in Q1 2014 comprise class A office buildings and that is 156 thousand sq. m. It is worth noting that the largest new office buildings commissioned in Q1 2014 include: Eurasia Tower (86 800 sq. m.) in MIBC "Moscow City", it accounts for about 38% of the total area, delivered in Q1 2014.

New supply in Class B comprised 73 thousand sq. m. The largest Class B office buildings commissioned in Q1 2014 include Vorontsovskaya Str. 41-43, Rozhdestvenka Str. 8/1, BP Solutions, Phase III at 148 Varshavskoe highway.

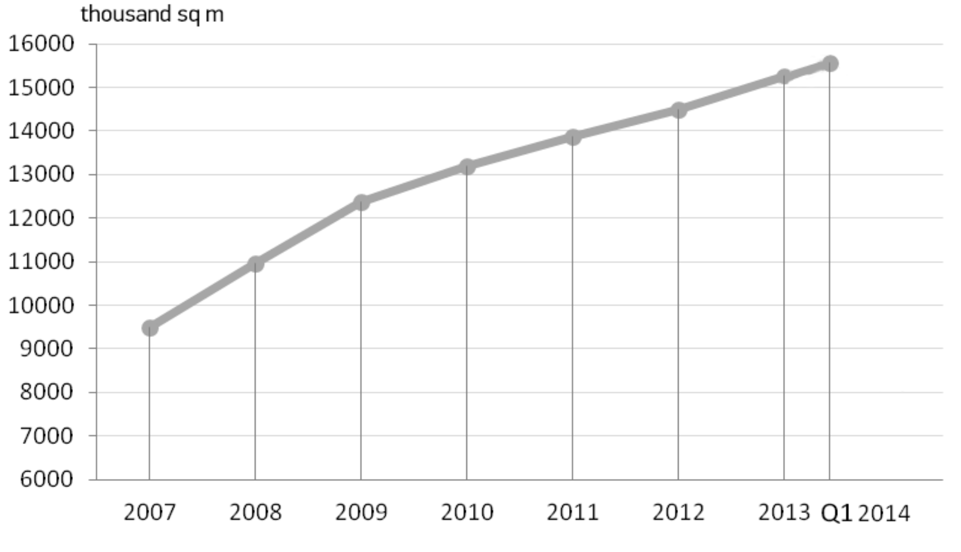
Major properties commissioned in Q1 2014*

Office building	Address	Developer	Class	Office area, sq m
Eurasia Tower	Presnenskaya emb., site 12	Nafta Moscow / MCG Group	A	86 800
Mirax Plaza, bld. D	Kutuzovsky pr-t 32, cor. D	Stroygazconsulting Group	A	30 000
Mebe One Khimki Plaza	Leningradskaya Str. 25	Mebe Construction	A	29 937
Vorontsovskaya Str. 41-43	Vorontsovskaya Str. 41-43	VTB	B+	19 800
Rozhdestvenka Str. 8/1	Rozhdestvenka Str. 8/1	Bank of Moscow	B+	19 000
Solutions, phase 3	Varshavskoe sh. 148	Alfa-Design / Moskapstroy / MonArkh	B+	14 432
BP Avrora, phase 3, bld. F	Sadovnicheskaya Str. 82, cor. F	Forum Properties	A	9 166

** Buildings which were commissioned as well as those which reconstruction will be completed in Q1 2014*

Increase in total supply of quality office space in Q1 2014 comprised 1,5 %.

Total stock trend



1,3 mln. sq m is expected to be commissioned to Moscow office market by the end of 2014. According to our estimates part of office buildings expected to be commissioned in 2014 will be postponed to 2015, thus during Q2-Q4 2014 not more than 700 thousand sq. m will be commissioned. Major part of new construction, which is about 80% is outside Third Transport Ring.

The following buildings are expected to be completed: OKO Tower, ComCity phase I, President Service, Mirax Plaza Towers bld. A, BC Lotos, BC Poklonnaya 3, Evolution Tower.

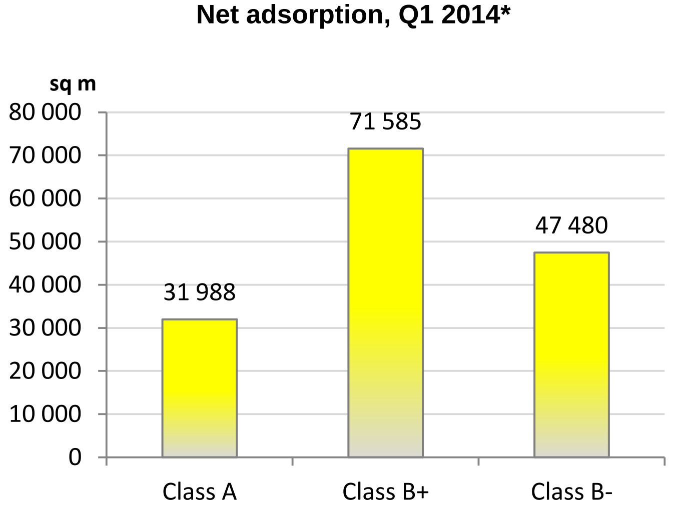
Major properties to be completed in 2014

Property	Address	Developer	Class	Office area, sq m
OKO	Testovskaya Str. 16	Capital Group	A	116 280
ComCity, phase Alfa	2 km ot MKAD po Kievskomu sh.	PPF Group	A	107 500
President-Service	Kulneva Str. 4, bld. 2	International Center Development	A	96 096
Lotos	Odesskaya Str. vl. 2	MR Group	B+	88 200
Poklonnaya 3	Poklonnaya Str. vl. 3	ALPINE	A	85 572
Evolution Tower	Presnenskaya emb.	Snegiri Development	A	80 500
Vereyskaya Plaza III	Vereyskaya Str. 29, bld. 33,134	Plaza Development	B+	76 900
Neo Geo	Butlerova Str. 17	Stone Hedge	B-	70 000
Mirax Plaza, cor. A	Kutuzovsky pr-t 32, кcor. A	Promsvyazbank	A	69 590
K-Park	Kashirskoe sh. 3, cor. 2	Plaza Development	B+	64 140
Port Plaza	Proektiruemy pr-d №4062, 6	Plaza Development	B+	62 000
Vodny	Golovinskoe sh. vl. 5	MR Group	B+	61 570
Mirax Plaza, cor. B	Kutuzovsky pr-t 32	Stroygazconsulting Group	A	59 495
Savelovsky City, phase I	Skladochnaya vl. 1	MR Group	B+	51 451
Pallau-RB	Rublevo-Uspenskoe sh. vl. 1	Ferro Story	A	46 500
Technopark Orbita, phase II	Kulakova Str. vl. 20	Amtel Properties	B+	39 645
Arcus III	Leningradsky pr-t 37A	AB Development	A	33 213
Aero City	Khimiki, Kurkinskoe sh., Butakovsky bay area	Vysota	A	32 635
Bolshevik, phase I	Leningradsky pr-t 15	O1 Properties	A	28 150
Khanoj-Moscow	94 km MKAD, Yaroslavskoe sh.- Roterta Str.	Investment Company Incentra	B+	28 000
Aerodom	Leningradsky pr-t 37, cor. 7	PSN Group	B+	26 700
ROTA Tower	Khimki, Kirova Str.	MDK Group	B+	24 000

Demand

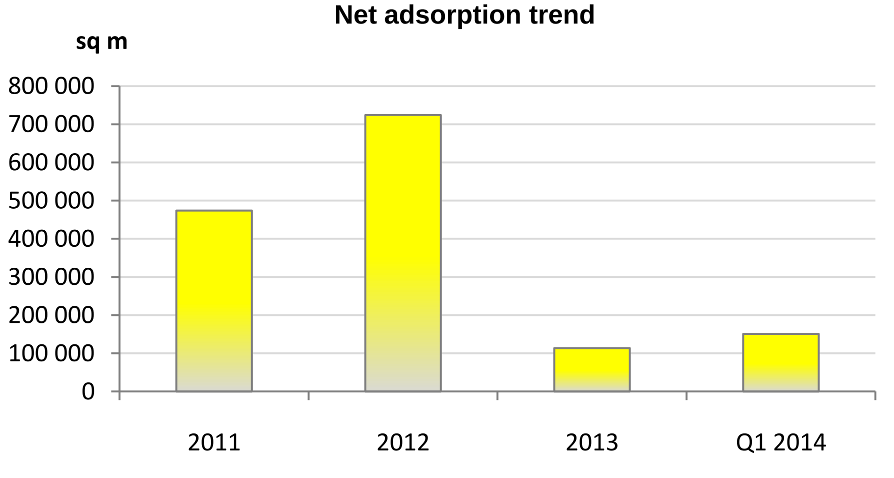
Net absorption of office space during the first three months remains low, but nevertheless it demonstrates a positive trend. Thus, the volume of net absorption increased by 8 times compared with the same period last year, and at the end of Q1 2014 it comprised 151 thousand sq. m.

The highest volume of net absorption, namely 72 thousand sq. m in Q1 2014 accounts for Class B + office buildings. This represents 47 % of the total absorption. Class B- office buildings' net absorption has also increased and by Q1 2014 comprised 47 thousand sq. m. This can be explained by the fact that many companies optimize their expenditures on office lease, that's why class B office buildings with more flex terms has become more attractive for tenants. The number of office purchase transactions has also increased and they mainly occur in Class B office buildings.



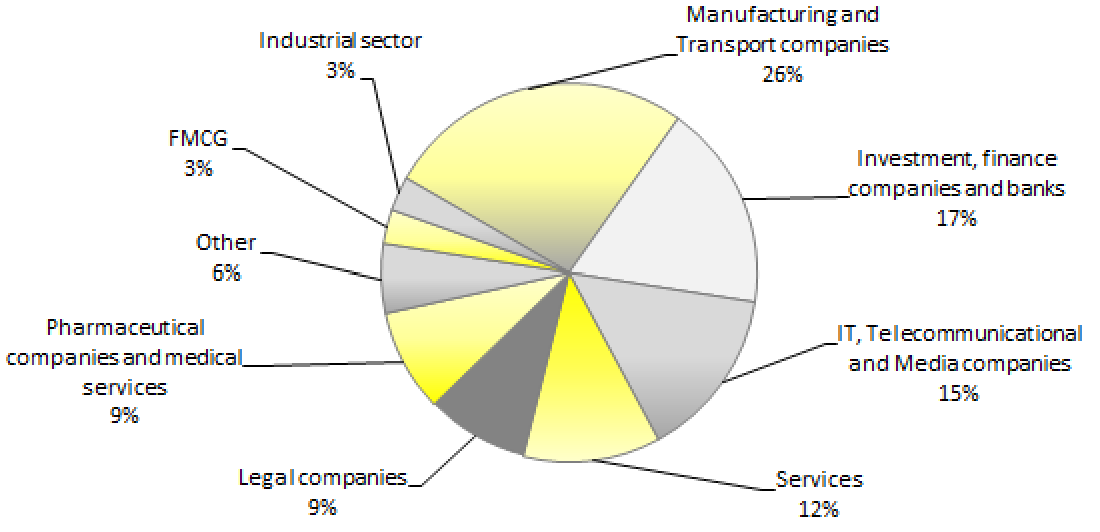
** Net absorption shows changes in the absorption of office space by tenants for a certain period.*
Net absorption is calculated as: S1 + Snew – S2, where
S1 – vacant office premises at the beginning of the given period, Snew – new supply of office premises for the given period, S2 – vacant office premises at the end of the given period.

The increase in the amount of net absorption results in a slight decrease of vacancy rate.



Considering the structure of demand by industries it should be noted that by the end of Q1 2014 we still observe the highest interest from manufacturing and transport. They accounted for 26% of all requests received in Q1 2014 for office lease and purchase. Telecommunications, IT and financial companies still remain active. Requests from telecommunications and IT companies accounts for 15% and financial companies 17%. During the first three months the number of requests from FMCG sector has decreased by 7% and by the end of Q1 2014 comprised 3% of the total amount of requests.

The structure of demand according to the branch of business activity, Q1 2014



The analysis is based on the total number of applications received by ILM by the represented business branches within Q1 2014

Key deals in Q1 2014

Company	Area, sq m	Type of deal	Property	Adress
Systematic	17 370	lease	ComCity	2 km ot MKAD po Kievskomu sh.
PepsiCo	13 009	lease	Alcon	Leningradsky pr-t 72
Gazprom-Media*	12 292	lease	RochDel Center	Rochdelskaya Str. 20
Modis	3 954	lease	Wall Street	Valovaya Str. 35

** ILM acted as a consultant of the transaction*

Key deals in Q1 2014 (continued)

Company	Area, sq m	Type of deal	Property	Adress
Veropharm	3 500	lease	South Port	2 Yuzhnoportovy pr-d 16
Communication Group Apostol*	3 376	lease	Avion / Vasilyevskaya Str. 13, bld. 2	Leningradsky pr-t 47, bld. 2 / Vasilyevskaya Str. 13, bld. 2
Shvabe Capital (Rostechnologii)*	2 300	lease	Embankment Tower, block B	Presnenskaya emb. 10
Investgeoservis	1 938	lease	Principal Plaza	60-letia Oktyabrya pr-t 10A
Structure of the Government of Moscow region*	1 295	lease	PBC Myakinino, Section A	MKAD 65-66 km

** ILM acted as a consultant of the transaction*

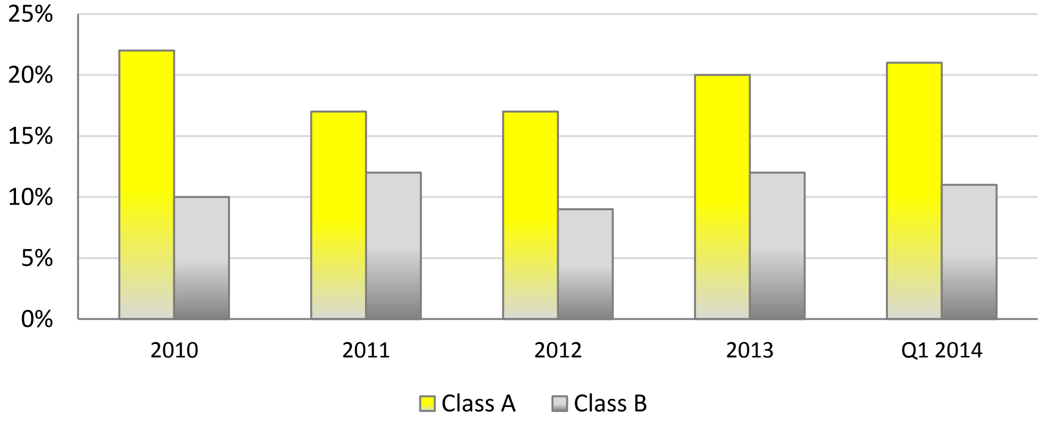
Vacancies

Increase in the amount of net absorption accompanied by a low level of new construction resulted in a slight decrease of vacancy rates in Moscow Office Market.
By the end of Q1 2014 on average vacancy rate comprised 13,3 % which is 0,3 % lower than at the same period last year.

End of Q1 2014 vacancy rate comprised 21% for class A office buildings and 14 % for class B+. The amount of vacancy rate in Class A office buildings has slightly increased by 1 % compared to Q4 2013. This is due to release of a number of large office buildings.

Class B+ office buildings demonstrated the opposite dynamics, as they were more demanded at the beginning of the year. By Q1 2014 the level of vacancy rate here has decreased by 1%.
In class B- office buildings the level of vacancy rate remained unchanged and comprised 8%.

Vacancy rate trend

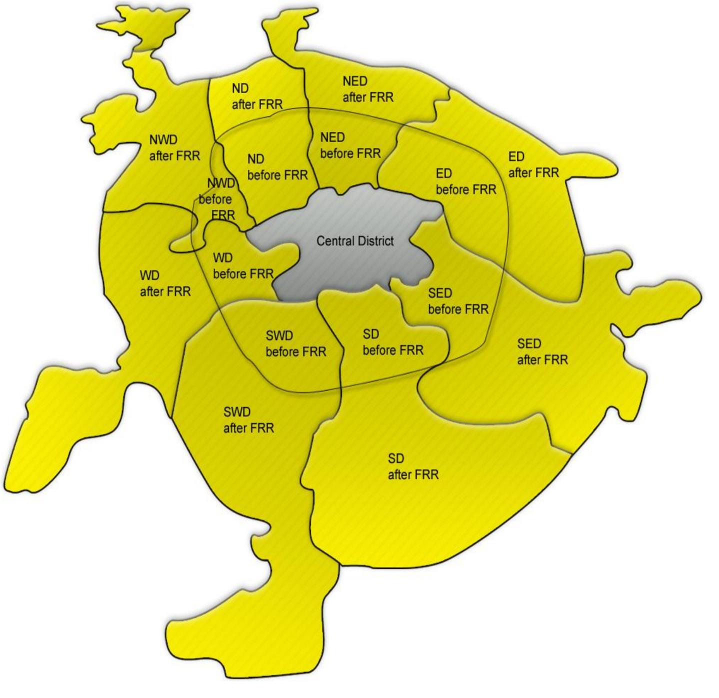


If we consider the distribution of available space according to geography during Q1 2014 we can observe considerable changes in the following districts: Western District before Fourth Ring Road "WD before FRR" where vacancy rate has increased by 4 times and South Western District after Fourth Ring Road "NWD after FRR" where vacancy rate has increased by 2.5 times thus amounting to 83% and 63% respectively. This is due to delivery of new large office buildings in this area such us Mirax Plaza bld. D ("WD before FRR") and Mebe One Khimki ("NWD after FRR").

Inside Central Business District delivery of several large buildings restrained the reduction of vacancy rates for Class A and Class B. During Q1 2014 vacancy rates in theses districts remained unchanged and by the end of Q1 2014 21% and 9% of Class A and B office buildings remained vacant.

Vacancy rate in various Moscow districts at the end of Q1 2014

District	Class A	Class B
Central District	21%	9%
NED before FRR	3%	5%
NED after FRR	-*	26%
ED before FRR	59%	12%
ED after FRR	-*	4%
SED before FRR	-*	6%
SED after FRR	-*	9%
SD before FRR	4%	13%
SD after FRR	-*	16%
SWD before FRR	0%	25%
SWD after FRR	24%	21%
WD before FRR	83%	22%
WD after FRR	0%	19%
NWD before FRR	-*	0%
NWD after FRR	64%	15%
ND before FRR	21%	6%
ND after FRR	28%	7%



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

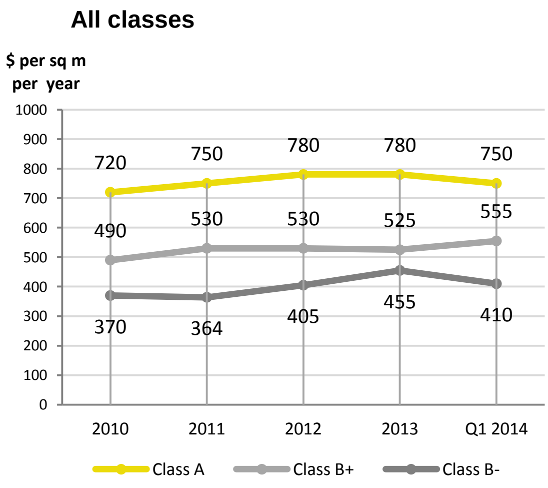
Rents

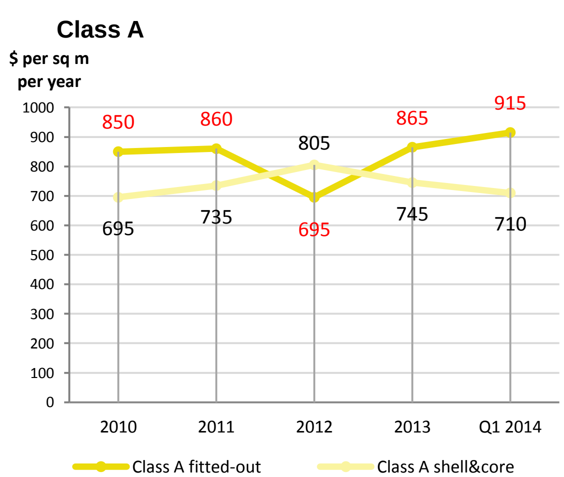
The beginning of the year in Moscow Office Market, as in the country's economy and the world in general , was characterized by a fairly high level of uncertainty. This could not but affect rental rates and many landlords were forced to reduce rental rates to attract tenants. Also in Q1 2014 there were significant currency fluctuations.

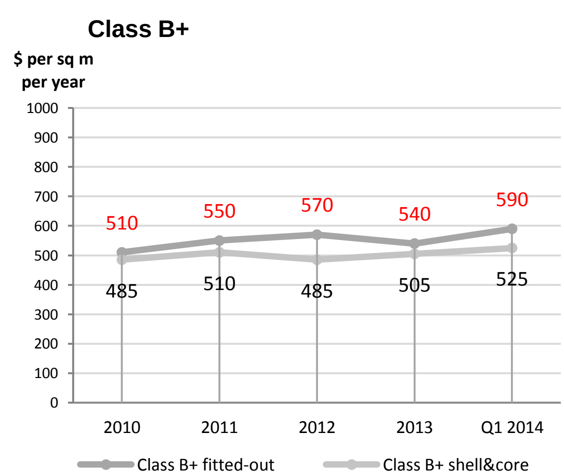
Thus, in Q1 2014 the average asking rental rates for Class A decreased from $ 780 per sq m per year to $750 per sq m per year. The same level of asking rental rates for class A premises was in 2011. Average rental rate for class A office buildings located inside the Garden Ring comprised $ 1010 per sq m per year which is $ 40 less than at the end of last year.

Speaking about rental rates dynamics in class B+ office buildings average asking rental rates increased from $525 per sq. m per year to $555 per sq. m per year. This is due to changes in requirements for Class A office buildings in accordance with new Moscow Research Forum classification when part of Class A office buildings were transferred to Class B+. In future we expect that rental rates will be adjusted downward.

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







Excluding Operation al Expenses and VAT (18%)

Average asking rental rates in Class B- office buildings have also decreased and comprised $410 per sq m per year which is $45 less compared with the end of last year.

If we consider lease terms depending on the condition of the premises, by the end of Q1 2014 rental rates in class A office buildings comprised $915 per sq. m per year for office premises with fitted-out and $710 per sq. m per year for premises in shell&core.

Average asking rental rate for class B+ comprised $590 per sq. m. per year for premises with fitted-out and $525 per sq. m. per year for premises in shell&core.

Average base rental rates in various Moscow districts at the end of Q1 2014

District	Class A		Class B+		Class B-
	fitted-out	shell&core	fitted-out	shell&core	
Central District	$1 005	$785	$780	$730	$505
NED before FRR	-*	-*	$545	$510	$355
NED after FRR	-*	-*	$330	$260	$310
ED before FRR	$665	$705	$560	$330	$295
ED after FRR	-*	-*	-*	-*	$290
SED before FRR	-*	-*	$435	$385	$370
SED after FRR	-*	-*	$430	-*	$345
SD before FRR	$720	-*	$515	$395	$375
SD after FRR	$760	-*	$460	$405	$330
SWD before FRR	-*	-*	$730	$625	$425
SWD after FRR	$745	-*	$610	$550	$455
WD before FRR	-*	-*	$1 005	$605	$450
WD after FRR	-*	-*	$435	$485	$375
NWD before FRR	-*	-*	-*	-*	-*
NWD after FRR	$540	$450	$535	$340	$375
ND before FRR	$705	$740	$575	$565	$450
ND after FRR	$415	$345	$320	$365	$430

Excluding Operation al Expenses and VAT (18%).
** Premises of the indicated class which are not applicable in the indicated district.*
*** FRR – Fourth Ring Road*
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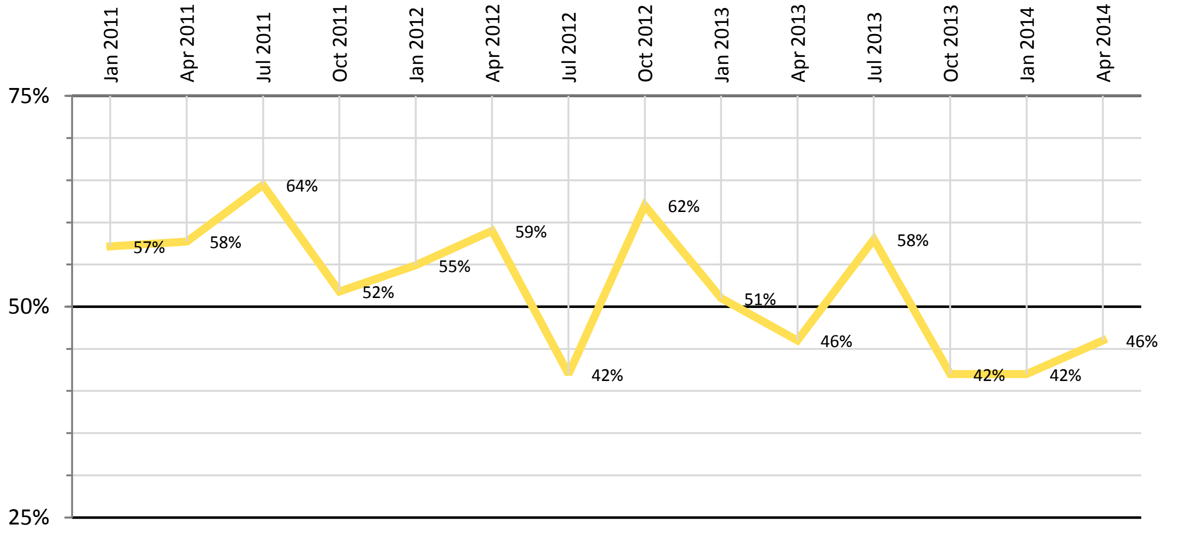
ILM Rent Expectations Index

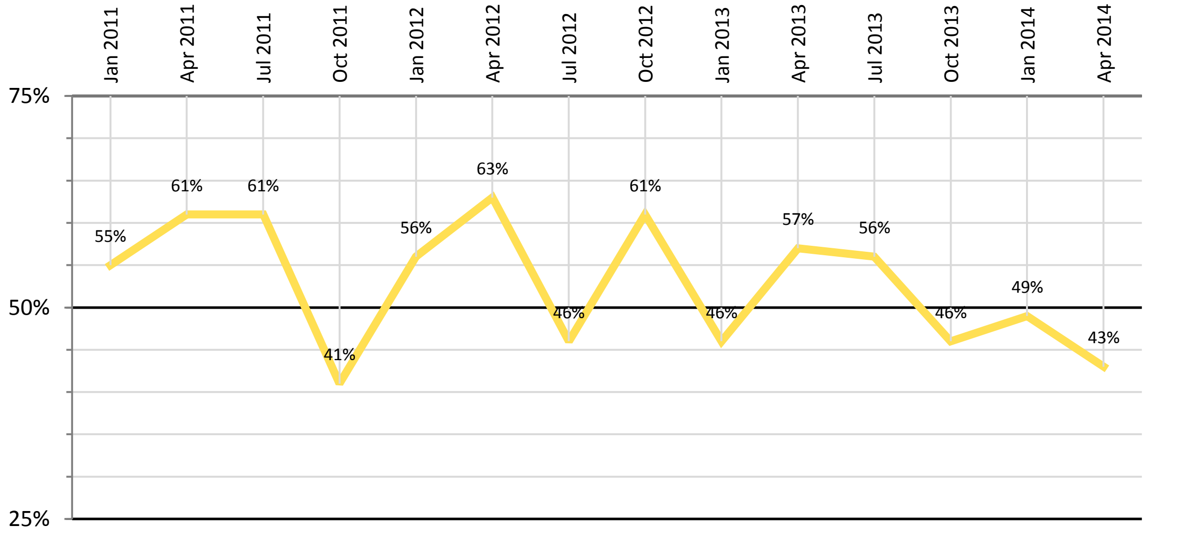
Starting from last October Rent Expectation Index demonstrated decline. Most landlords decreased rental rates. This tendency continued till the end of 2013 and by the end of the year reached the level of 42% for class A office buildings and 49% for class B+ .

During Q1 2014 Rent Expectation Index remains low and doesn't overcome the mark of 50 points. Most of the landlords still hold the position to lower rental rates. Thus, at the end of Q1 Rent Expectation Index is 46% for Class A and 43% for class B +.

ILM REI, Class A



ILM REI, Class B+



Rent Expectation Index shows how landlords of high-quality office space in Moscow perceive current commercial real estate market changes. ILM REI (Rent Expectation Index) indicators are derived from monthly surveys of about 400 office property Landlords. The Index measures Landlords' rental rates expectations based on the changes of rental rates requested by them. The Index shows what will happen to rental rates in a short-term perspective. Judging by the Index Landlords can figure-out rental rates expectations of other market players.

Taking into an account Rent Expectation Index indicators market players can make sound decisions whether to lease new office premises right now or to wait for more favorable market conditions. This movement of the Index up or down gives you and idea of what will happen with rental rates within a short-term perspective and indicates a general trend of rental rates expectations to professional market players.

REI allows to predict the level of rental rates within 3-6 months perspective. This is the average time required for search / selection of an office and signing lease agreement. The Index also registers rental rates velocity associated with these expectations.

REI is calculated on the basis of survey of landlords' opinions of the most liquid office buildings. Such buildings are attractive to large investors, building managers and end users. The Index value is calculated as a simple sum of percentage changes in the values of "growth" (increase in rental rates) and half percent of the value of "no change" (rental rates remain at current levels) compared to the previous period.

Compared to rental rates indicators REI is clear of any structural factors, such as geographic location, rental rates level at different periods of time. The Index does not measure up absolute growth of rental rates, it indicates the general trend – upward or downward (whether the market expects rental rates go up or down). Thus, the Index is a kind of a slice of major landlords' expectations.

PMI is calculated as follows:

$$I = P_{growth} + 0{,}5 * P_{no\ change} ,$$

I – Rent Expectation Index,
P_{growth} – percentage number of answers that reported "growth"
P_{change} – percentage number of answers that reported "no change"

Index may vary between 0% and 100 %. If Rent Expectation Index is above 50%, there is a high probability of an increase in rental rates in the upcoming months. The value of the deviation from the equilibrium value of 50% indicates a downward / upward trend. The value less than 50 % reflects the landlords' expectation for rental rates reduction. The turn in the Index diagram shows the turn of the whole rental rates trend. Thus, Rental Rates index helps to predict commercial property market behavior and is crucial for a decision-making process.