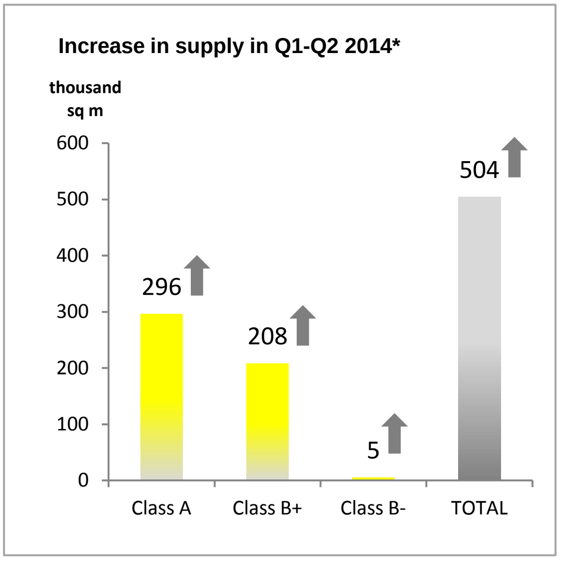
Moscow, Q2 2014

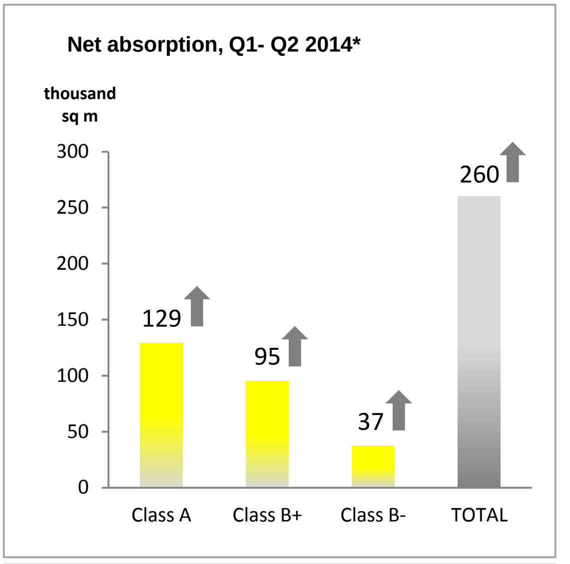
Office Market Report

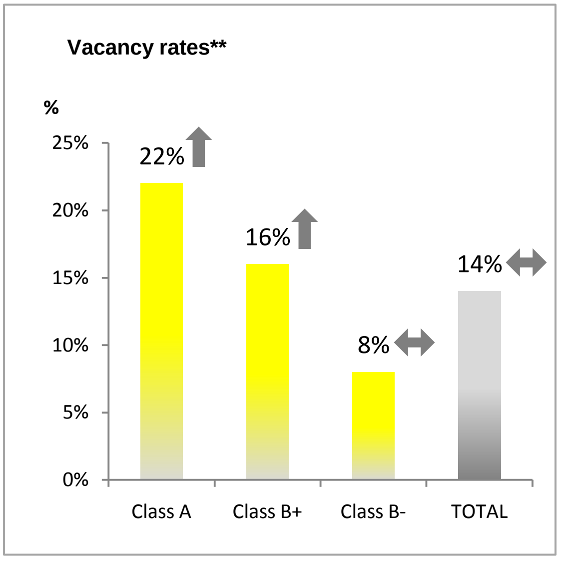
ILM

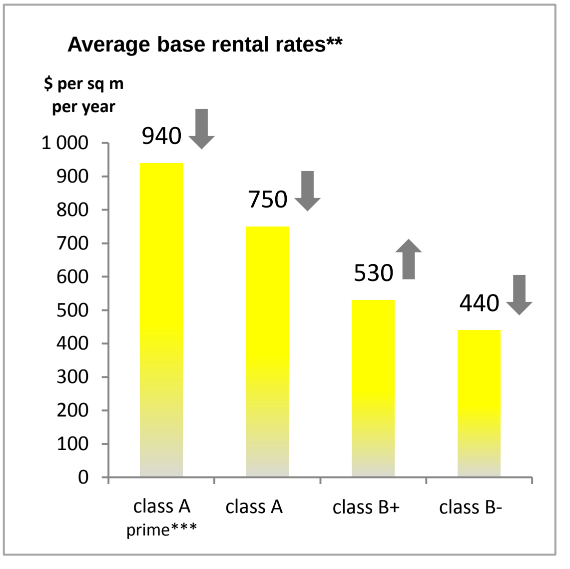
real estate intelligence

Main indicators, Q2 2014









** Comparing to Q2 2013*
*** Comparing to the end of 2013*
**** Cass A office buildings within the Garden Ring*

- The total supply of quality office space in Moscow at the end of Q2 2014 reached 16 mln. sq m. During the first two quarters about 504 thousand sq m were delivered, 59 % of which are class A and class B. Thus, the volume of new construction exceeds by 41% the volume of the previous year and is the highest since 2009.

- During the 1st half of 2014 net absorption increased by 110 thousand sq m. Thus, following Q1 and Q2 2014 the amount of net absorption achieved 260 thousand sq m which is by 308 thousand sq m higher than at the same period last year when its value was negative.

- Despite the positive trend, net absorption in the first half of 2014 is almost two times lower than the volume of new construction. This on average has led to an increase in vacancy rates during Q2 2014 up to 14%, which is similar to the end of 2013.

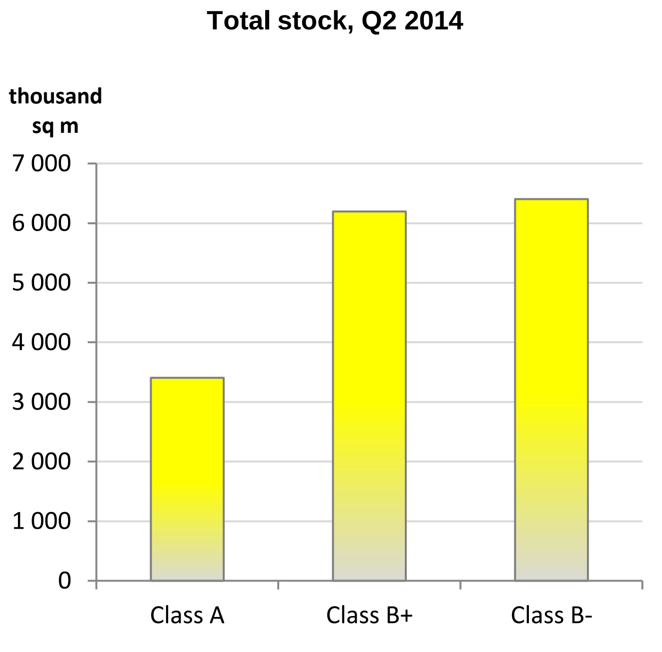
- Increased competition among high-quality office buildings as a result of growth in supply, currency fluctuations, as well as the high level of uncertainty in the economy of the country and the world as a whole, could not but affect the dynamics of rental rates in quality office space. During the first six months, the average asking rental rates for class A - $ 750 per sq m per year, for class B + - $ 530 per sq m per year. For class B - -$ 440 per sq m per year.

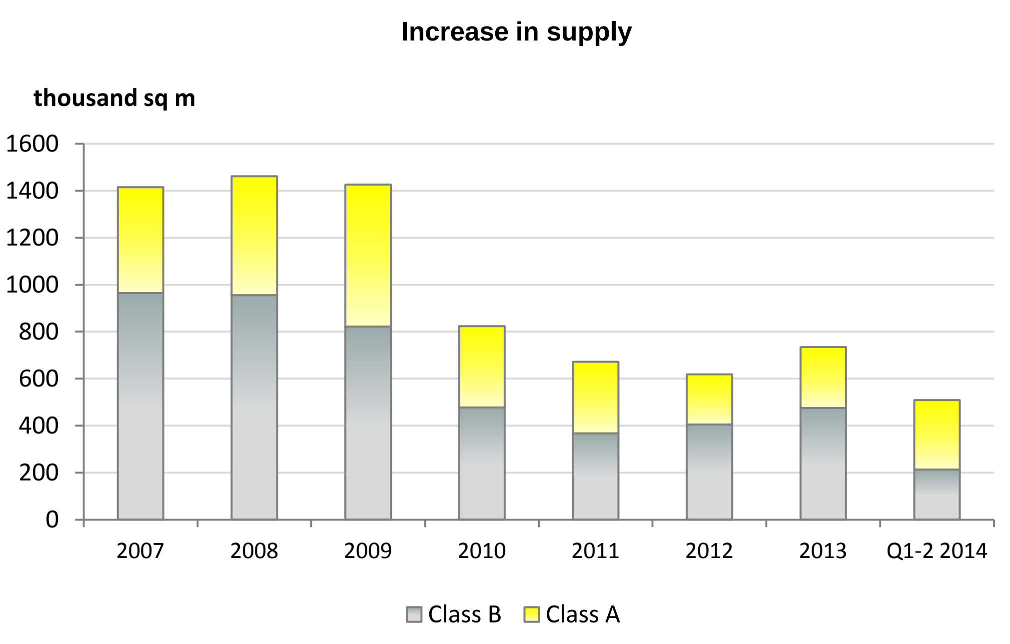
Supply

The total supply of quality office space in Moscow at the end of Q2 2014 reached 16 mln. sq m and amounted to 3.4 million for class A (21%) and 12.6 mln. for class B (79%).

As we expected, the first half of the year showed an increase in new supply. During Q1 – Q2 2014 about 504 thousand sq m were delivered, 59% of which are class A and 41% are class B and this figure is the highest since 2009.

Increase is due to new supply, especially due to completion of business centers the construction of which was frozen due to financial crisis of 2008 – 2009, such as Eurasia Tower, President Plaza etc.





Due to decentralization tendency more high-quality business centers have been delivered outside the Garden Ring. During the 2nd half of 2014 the largest amount of new supply is beyond the boundaries of Central District that is 68 % of the total amount of new construction. The highest amount of new construction is within Western Administrative District where 212 thousand sq m were delivered. The largest projects delivered in this area are office building 3 Poklonnaya Str., President Plaza and Arcus, Building III .

If we consider new construction in Q2 2014 only 10 % of total new supply were delivered in Central Business District.

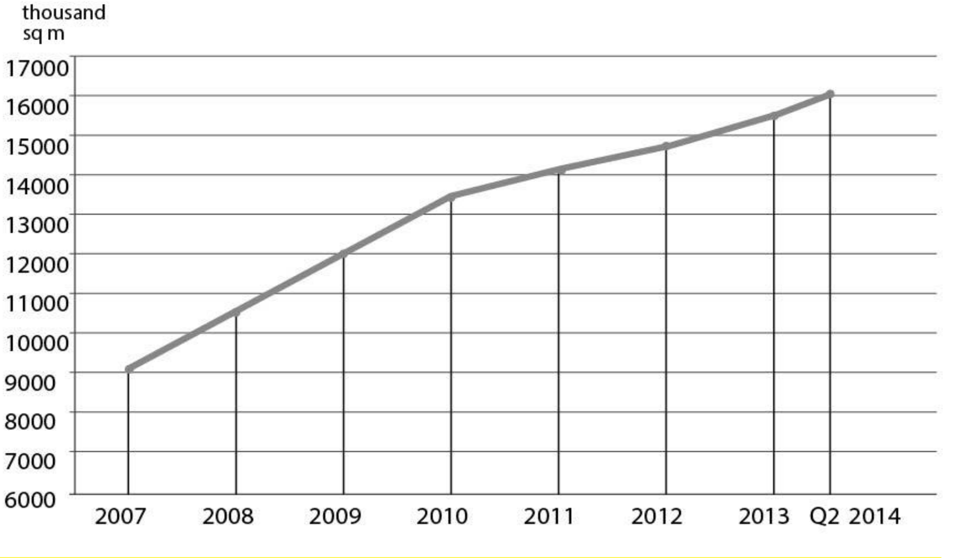
Major properties commissioned in Q2 2014*

President Plaza	4 Kulneva Str., bld. 2	International Center Development	A	96 096
Poklonnaya 3	3 Poklonnaya Str.	ALPINE	B+	85 572
Arcus III	37 A Leningradsky pr-t	AB Development	A	33 213
Khanoj-Moscow	94 km MKAD, Yaroslavskoe sh.-Roterta Str.	Investment Company Incentra	B+	28 000
Arma 19	5 Nizhny Susalny per., bld. 19	Bolshoy Gorod	B+	19 049
Omega 2	26 Leninskaya Sloboda Str.	City & Malls	B+	13 650
Robert Bosch Headquarters	Vashutinskoe sh. 6 km ot MKAD	Robert Bosch Russia	B+	10 650

** Buildings which were commissioned as well as those which reconstruction will be completed in Q2 2014*

During the 1st half of 2014 total increase in supply comprises 8.7% for class A and 1.7% for class B, and the total growth - 3%.

Total stock trend



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During the second half of 2014 about 1.1 mln sq m of office space is announced for delivery in Moscow office market. However, according to our estimates, taking into an account the speed of construction, delivery of some buildings will be shifted to 2015, so it is likely that in the next two quarters no more than 750 thousand sq m will be delivered and it will exceed the level of 2010 and will be the maximum during the post-crisis period.

The following large buildings will be delivered to the market as OKO Tower, MFC ComCity – Phase I, Lotus business center, Evolution Tower. The main share of new construction (more than 70 %) is in the districts outside Third Transport Ring.

Such increase in new supply will strengthen the competition between high-quality buildings and will give the tenants an opportunity to choose office buildings with most favorable commercial terms.

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
Lotos	Odesskaya Str. vl. 2	MR Group	A	88 200
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
Sirius 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
Suvorov Plaza	Kutuzovsky pr-t 32	Stroygazconsulting Group	A	60 000
Savelovsky City, phase I	Skladochnaya vl. 1	MR Group	B+	51 451
Atlantic	Mozhaisky Val Str. vl. 8	Dallas Development & Construction	A	48 500
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
Aero City	Khimiki, Kurkinskoe sh., Butakovsky bay area	Vysota	A	32 635
Bolshevik, phase I	Leningradsky pr-t 15	O1 Properties	A	28 150
Aerodom	Leningradsky pr-t 37, cor. 7	PSN Group	B+	26 700
Minskaya Plaza	Minskaya Str. vl. 2	Plaza Development	B+	26 400
ROTA Tower	Khimki, Kirova Str.	MDK Group	B+	24 000
Verkh. Krasnoselskaya Str. 3, bld. 2	Verkh. Krasnoselskaya Str. 3, bld. 2	Bolshoy Gorod	B+	22 600

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Demand

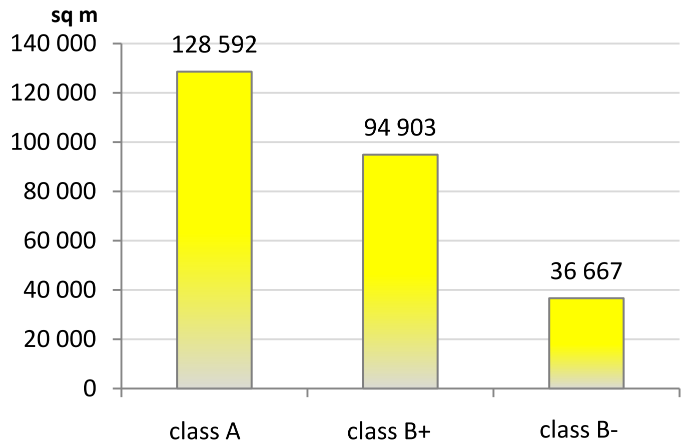
During the first half of the year net absorption of office space has shown a positive trend. During six months this figure has risen to 110 thousand sq m. Thus, following Q1 – Q2 2014 the volume of net absorption reached 260 thousand sq m, which is 308 thousand sq m higher than last year when its value was negative.

The largest value of net absorption that is 129 sq m according to Q2 results is for class A office buildings, which is 50% of the total amount of absorption. Only 21 % of net absorption is for class A. It shows an increase in demand for class A office buildings which is due to reduced rental rates because of high level of supply when the tenants have an opportunity to choose the most favorable commercial terms.

Net absorption has also increased in class B+ office buildings, by the end of Q2 this figure reached 95 thousand sq m. In class B- this figure comprises 37 thousand sq m.

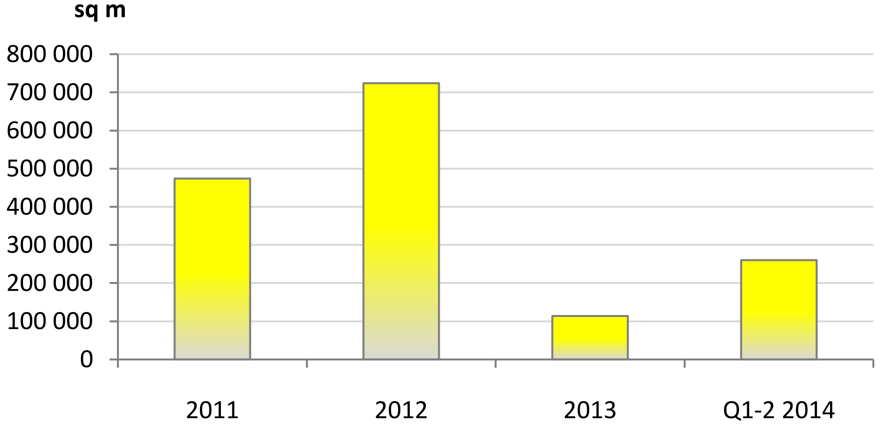
It should be also noted that if we consider the structure of transactions by the end of Q2 2014 we see an increase in the number of deals on re-negotiation. This is due to the instability in Moscow office market and the economy, when many tenants prefer to extend the current lease agreement.

Net adsorption, Q2 2014*



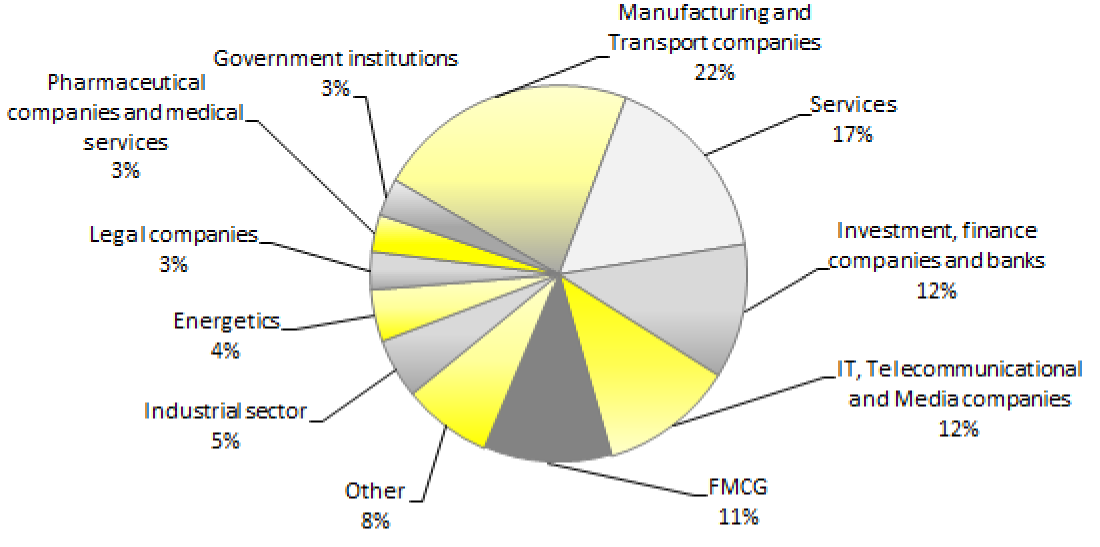
** Net absorption shows changes in the absorption of office space by tenants for a certain period.*
Net absorption is calculated as: S1 + Snew – S2, where
S1 – vacant office premises at the beginning of the given period, Snew – new supply of office premises for the given period, S2 – vacant office premises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

Net adsorption trend



Considering the structure of demand by industries it should be noted that during Q1 2014 we still observe the highest interest from manufacturing and transport companies. They account for 22 % of all requests received by ILM for office lease. By the end of Q2 2014 we see an increase of interest in office lease from companies, providing professional services. During 6 months this figure has risen from 11 % to 17 %. A steady demand is also demonstrated by IT and telecommunications sectors (12 %). Investment and financial companies, which previously were leading in demand for office lease in contrast showed reduced activity. The number of requests from these companies reduced by 7% at the end of Q2 2014 and amounted to 12% of the total demand. This is due to cautions in decision-making because of the risks associated with the introduction of economic sanctions against Russia as a result of Ukrainian conflict.

The structure of demand according to the branch of business activity, Q2 2014



The analysis is based on the total number of applications received by ILM by the represented business branches within Q1-2 2014

Key deals in Q2 2014

Company	Area, sq m	Type of deal	Property	Adress
Bank RosCredit*	3 620	lease	Matveevsky	38 Prechistenka Str.
Tele2	2830	lease	Metropolis	16 F Leningradskoe sh.
CMS	1 624	lease	Naberezhnaya Tower	10 Presnenskaya emb.
City Ads*	1531	lease	Apelsin	3 Stolyarny per., bld. 6

** ILM acted as a consultant of the transaction*

Key deals in Q2 2014 (continued)

Company	Area, sq m	Type of deal	Property	Adress
NefteMetSnab*	1 500	lease	Bol. Tatarskaya Str. 29	29 Bol. Tatarskaya Str.
Homeland Group	1500	lease	Partiyny per. 1	1 Partiyny per.
OTP Bank	1 466	lease	Alcon	72 Leningradsky pr-t
Actis Wunderman	1432	lease	Arma 19	5 Nizhny Susalny per., bld. 19
Wella	1 332	lease	Wall Street	35 Valovaya Str.
TS Logistics	1105	lease	Capital City	8 Presnenskaya emb., bld. 1

** ILM acted as a consultant of the transaction*

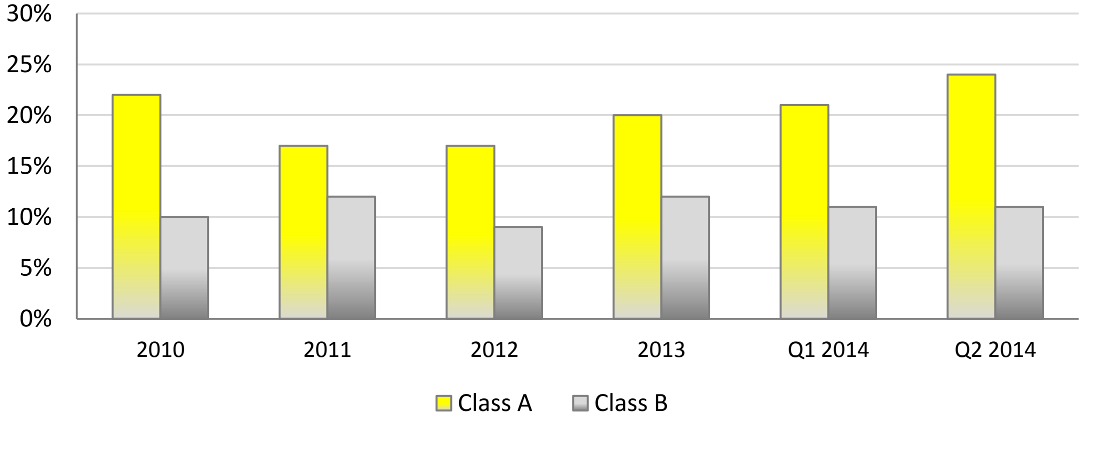
Vacancies

Despite positive dynamics net absorption for class A is about 2 times lower than the volume of new construction. This has led to an increase in vacancy rates during Q2 on average up to 14%, which corresponds to the end of 2013.

Vacancy rate for class A at the end of Q2 2014 comprised 22 %. By the end of the first half of 2014 this figure has risen by 2 % which is caused by reduction of the volume of new construction.

The range of vacancy rate varies depending on the location of office buildings. The lowest vacancy rate is observed in South Western District up to Fourth Ring Road (SWD up to FRR) and Western Administrative District outside Fourth Ring Road (WD outside FRR). The highest vacancy rate in class A is within Western Administrative District up to Fourth Ring Road (77 %) and South Western Administrative District outside Fourth Ring Road (75%). This is due to delivery of new office projects in these submarkets, such us President Plaza, Mirax Plaza, Bld. D, Mebe One Khimki Plaza in North Western Administrative District outside Fourth Ring Road.

Vacancy rate trend



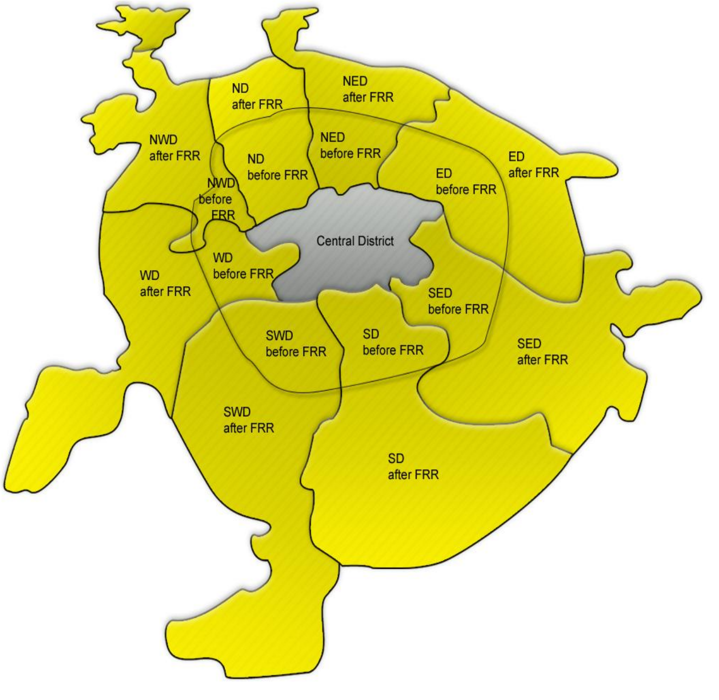
In Central Business District delivery of two large office projects such us Eurasia Tower, and Aurora Business Park, Bld. F restrained the reduction of vacancy rates. During 6 months of 2014 the level of vacancy rates remained unchanged and by the end of Q2 2014 comprised 21%.
In class B+ vacancy rate comprised 16% and 8 % for class B-. The level of vacancy rate in class B+ office segment has risen by 1 % compared to Q4 2013. In class B- this figure has remained stable.

The highest value of vacancy rate is in class B office segment in North Eastern Administrative District outside Fourth Ring Road. It can be explained by a low demand in this district.

In Central Administrative District in Q1 – Q2 several class B office buildings were delivered, which were constructed for the end user and where a largest part of the premises was leased out. It has limited an increase in the growth of vacancy rates in this class during the 1st half of 2014. The figure has risen only by 1 %.

Vacancy rate in various Moscow districts at the end of Q2 2014

District	class A	class B
Central District	21%	10%
NED before FRR	3%	7%
NED after FRR	-*	31%
ED before FRR	52%	12%
ED after FRR	-*	4%
SED before FRR	-*	6%
SED after FRR	-*	9%
SD before FRR	4%	10%
SD after FRR	-*	16%
SWD before FRR	0%	24%
SWD after FRR	21%	24%
WD before FRR	77%	16%
WD after FRR	0%	17%
NWD before FRR	-*	7%
NWD after FRR	75%	13%
ND before FRR	19%	7%
ND after FRR	33%	7%



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

Rents

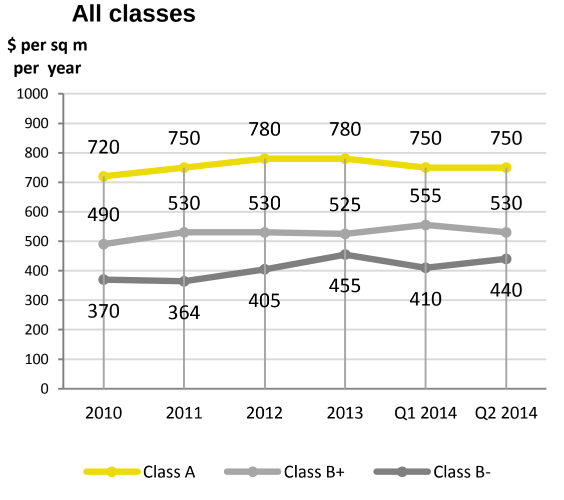
Increased competition in the market between high-quality office buildings as a result of growth in supply, currency fluctuations, as well as the high level of uncertainty in the economy of the country and the world as a whole, could not but affect the dynamics of rental rates for quality office space.

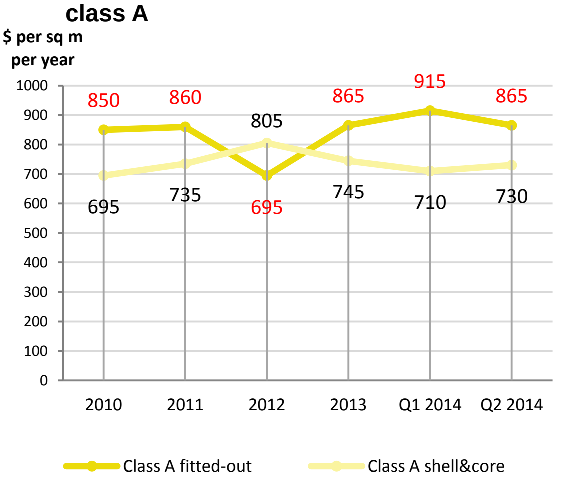
So, by the end of 6 months of 2014 the average asking rental rates in class A decreased by 4 % compared to the end of 2013 and by the end of Q2 comprised $750 per sq m per year. It should be noted that the average rental rate for class A remained unchanged compared to Q1 2014. For class A office segment within the Garden Ring the average rent rate comprised $940 per sq m per year which is $110 lower than at the end of last year.

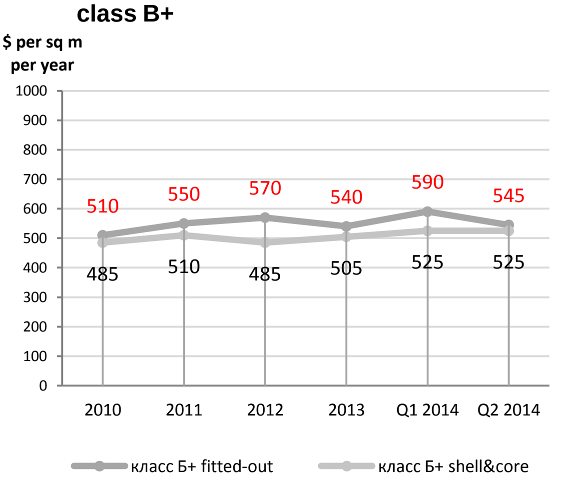
If we consider rental rates dynamics in class B+, average asking rental rates have slightly risen from $525 to $530 per sq. m per year, it is connected with an increase in the cost of rent for class B+ office premises located within Central Business District.

By the end of Q2 2014 average asking rental rate for class B- has slightly went down to $440 per sq m per year which is $15 lower than at the end of last year.

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







Excluding Operation al Expenses and VAT (18%)

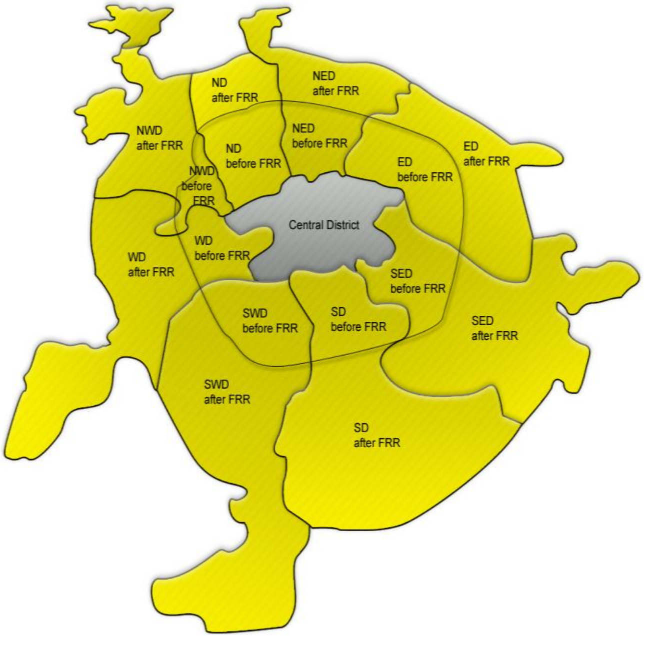
If we consider lease terms depending on condition of office premises, by the end of Q2 2014 rental rates in class A office buildings comprised $865 per sq m per year for office premises with fit-out and $730 per sq m per year for premises in shell&core.

Average asking rental rate for class B+ comprised $545 per sq.m per year for premises with fitted-out and $525 per sq m.per year for premises in shell&core.

Still in Moscow office market rental rates vary widely depending on the location and quality of office building.

Average base rental rates in various Moscow districts at the end of Q2 2014

District	class A		class B+		class B-
	fitted-out	shell&core	fitted-out	shell&core	
Central District	$945	$801	$820	$710	$559
NED before FRR	$700	-*	$580	$510	$392
NED after FRR	-*	-*	$320	$390	$329
ED before FRR	$550	$550	$615	$270	$310
ED after FRR	-*	-*	-*	-*	$290
SED before FRR	-*	-*	$375	$385	$260
SED after FRR	-*	-*	-*	-*	$390
SD before FRR	$700	-*	$515	$550	$470
SD after FRR	-*	-*	$470	$430	$390
SWD before FRR	$750	-*	$715	$605	$600
SWD after FRR	$740	-*	$590	$465	$470
WD before FRR	-*	$850	$760	$585	$450
WD after FRR	-*	-*	$440	$455	$390
NWD before FRR	-*	-*	-*	-*	-*
NWD after FRR	$530	$409	$590	$365	$380
ND before FRR	$900	$730	$600	$540	$410
ND after FRR	$445	$350	$590	$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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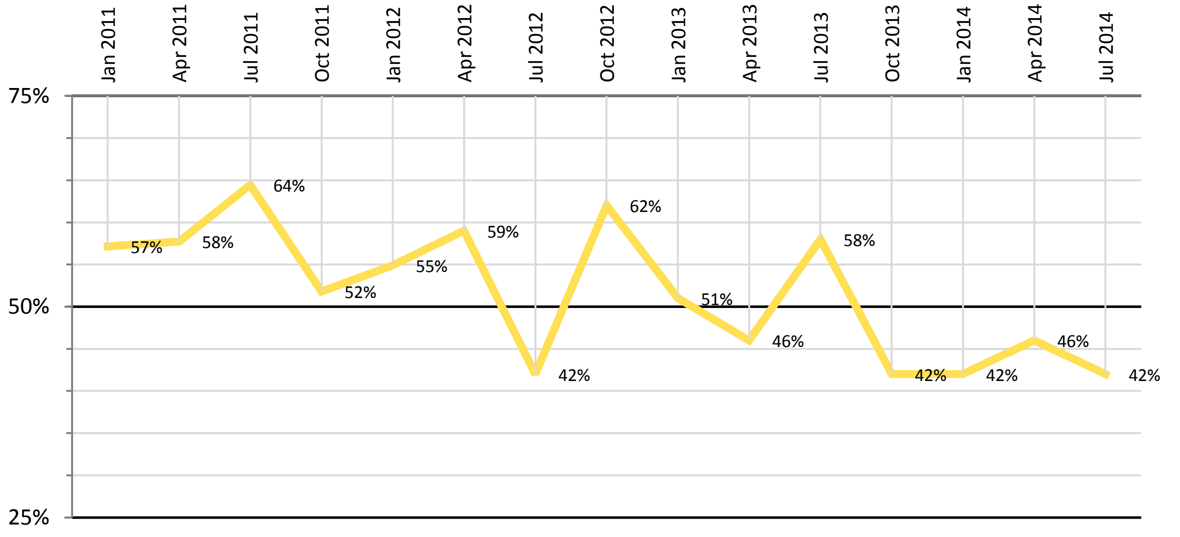
ILM Rent Expectations Index

At the beginning of 2014 expectations of rental rates growth remained low, the majority of landlords reduced rental rates. This tendency started last October when Rent Expectation Index overcome the mark of 50 points.

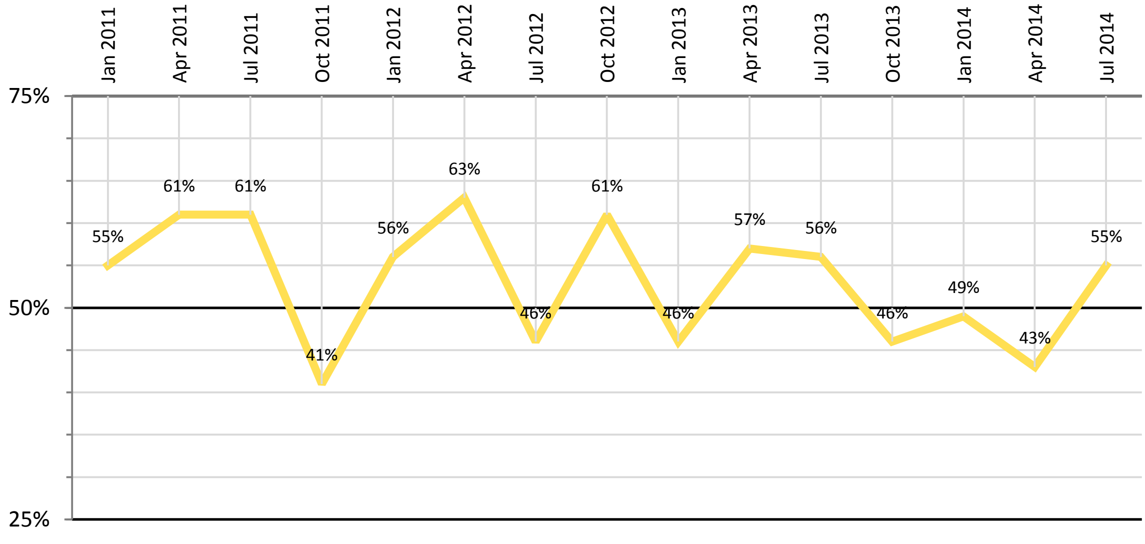
In class A office buildings in Q2 2014 the majority of landlords still maintained a position to reduce rental rates. By July Rent Expectation Index declined to the mark of 42 points.

In class B+ the situation is different, by July 2014 Rent Expectation Index demonstrates an increase, most landlords increase rental rates because of significant increase in property tax which is calculated on the basis of cadastral value of the building.

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.