CB RICHARD ELLIS
MarketView

Moscow Offices

DECEMBER 2009

Hot Topics

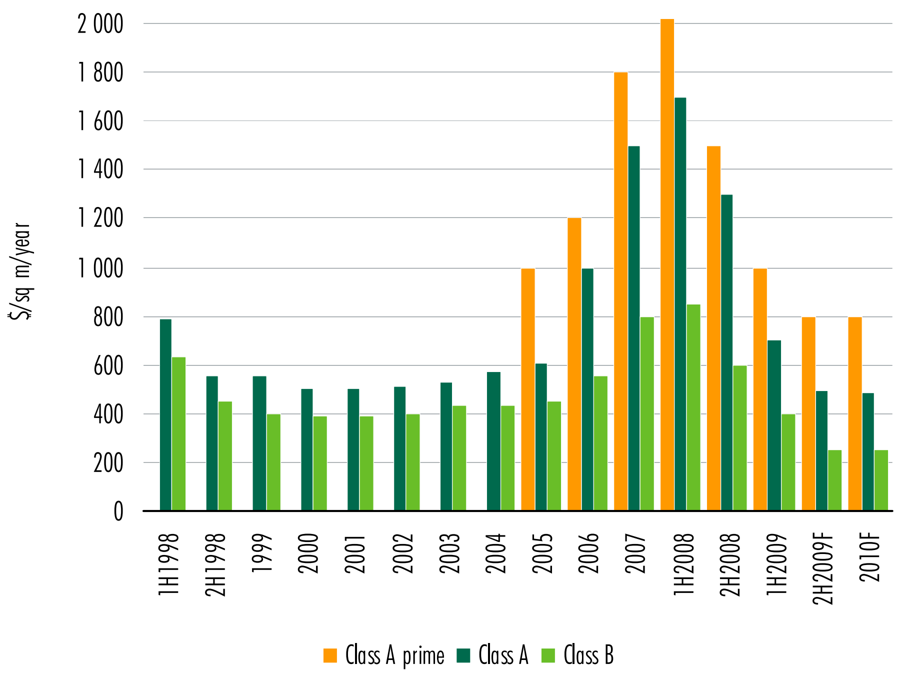
- Office space delivery in 2010 could drop to 925,000 sq m compared with 1,8 mln sq m of new delivery in 2009;
- The amount of vacant Class A space will increase, reaching up to 450,000 sq m (a vacancy rate of 25%);
- About 50% of deals on the market were for secondary space during 2009, which led to a rise in vacant space in shell&core condition.

As 2009 comes to an end, it is time to present some forecasts for Moscow's Office market in 2010. In order to predict the direction and level of office rents (a key market indicator), it is necessary first to understand the supply/demand balance likely to prevail next year. Demand for office space, which depends directly on overall demand in the wider economy, is expected to stabilize from the volatility seen in 2009. Although the World Bank is forecasting 3.2% GDP growth in 2010, unemployment, as a lagging indicator, will continue to rise – thus holding back higher demand for office space.

At the same time, as a result of difficulties with construction financing, the pipeline for 2010 will be considerably constrained. We project that the amount of office space that will come to the market in 2010 will be 925,000 sq m, considerably lower than in previous years, when over the three years 2007 to 2009 annual delivery exceeded 1.5 mln sq m.

The fall in supply will inevitably influence the overall market situation. As we forecast stable demand for office space during 2010, the market will see a fall in the vacancy rate. However, vacancy rates will not proportionally fall in all sectors and geographical areas of the Moscow Office Market. We expect that the amount of vacant space in shell&core condition will be growing, especially in the Class A sector. Besides, Class B-sector will see increase in vacancy, especially in decentralized areas of Moscow. At the same time we expect to see the trend of decrease of vacancy in central areas of Moscow (up to the Third Transportation Ring (TTK)), which we observed at the end of 2009, to continue in 2010.

Average Historic Asking Rents



Source: CB Richard Ellis

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INCREASE IN VACANCY RATE IN THE CLASS A SECTOR

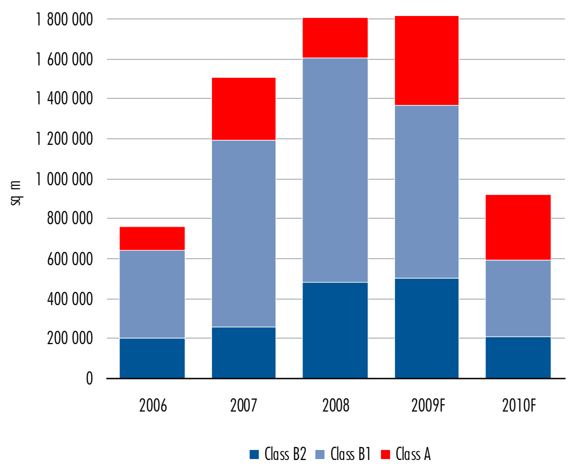
During 2009 we saw an increase in vacancy rate for the Class A sector compared with previous years. At the moment there is 309,000 sq m of Class A space vacant on the market (a vacancy rate of 20%). Taking into account demand dynamics and future delivery, we forecast that the amount of vacant Class A space will increase, reaching up to 450,000 sq m (a vacancy rate of 25%). Although we saw an increase in deals for class A space in 2009, and expect that this trend will be preserved during 2010, the level of demand will not be able to reduce the existing vacancy rate. We are strengthened in this view by the fact that a number of large-scale Class A projects are due to enter the market at the end of 2009 to 2010 and that very few pre-leases are signed on these so far:

• Domnikov BC	73,000 sq m
• Vivaldi Plaza	67,000 sq m
• WTC Phase III	30,000 sq m
• Summit BC	19,000 sq m
• Diamond Hall	35,000 sq m
• Capital City Phase II	50,000 sq m

INCREASE IN VACANT SPACE IN SHELL&CORE CONDITION

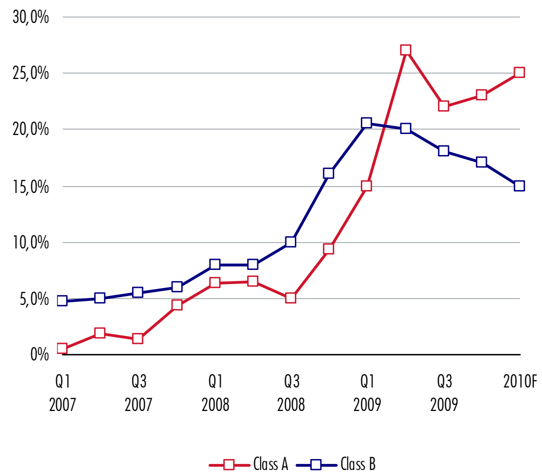
During 2009 there was an increase in demand for secondary space on the market due to the reluctance of tenants to pay for fitting out newly delivered office space. About 50% of deals on the market were for secondary space during 2009, which led to a rise in vacant space in shell&core condition, as more such space was delivered. During 2010 we expect this trend to continue, which will lead to a situation in which the amount of vacant newly delivered space (which is mostly in shell&core condition) will increase, even as the overall amount of vacant space decreases: as of Dec 2009 vacant space in shell&core condition amounts to 1.37 mln sq m, while the forecast for end of 2010 is 1.5 mln sq m.

New Delivery on the Market



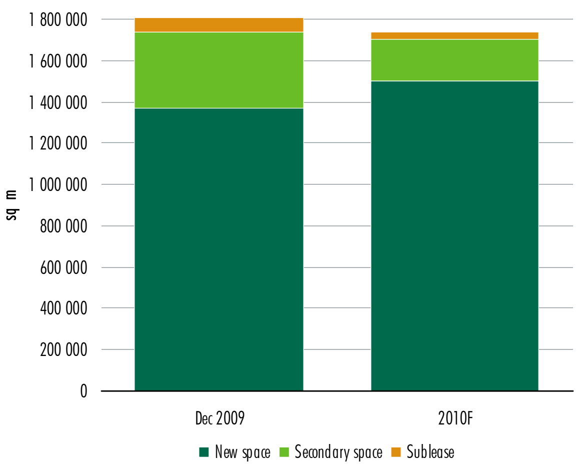
Source: CB Richard Ellis

Vacancy Rates by Class



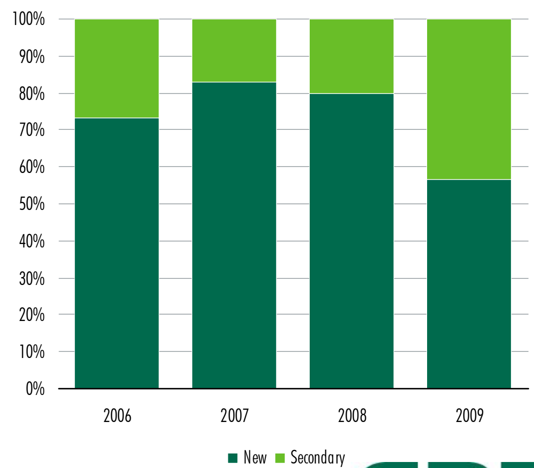
Source: CB Richard Ellis

Vacant Space Structure



Source: CB Richard Ellis

Take-up. New and Secondary Space



Source: CB Richard Ellis

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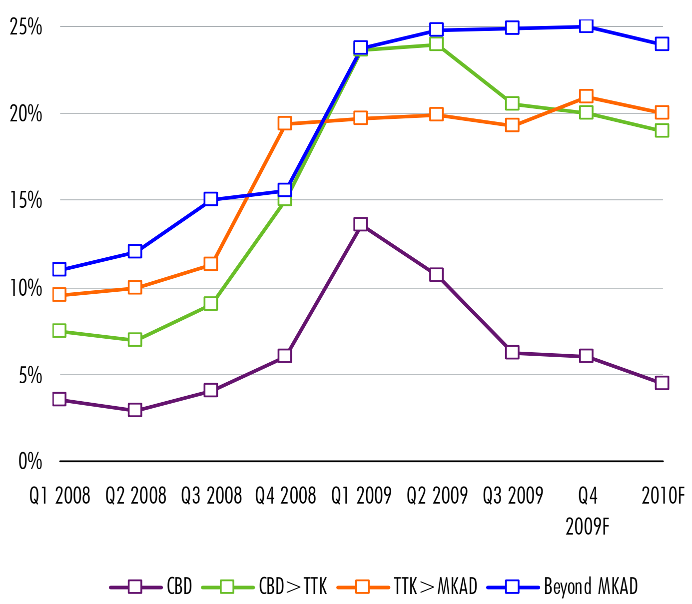
HIGH VACANT SPACE VOLUME IN CLASS B- AND IN DECENTRALISED AREAS

The increase in deals for better quality space and for space in central locations proves that office occupiers are taking advantage of the fall in rents to try and improve their office conditions. This has led to a situation in which lower quality space is being vacated. Taking into account that during 2010 the market will see the delivery of 200,000 sq m of reconstructed space, we anticipate a substantial increase in vacancy in Class B- buildings (especially in decentralized locations). The same will apply to Class B+ buildings in decentralized locations.

OUTLOOK

Based on the above analysis, we do not anticipate that rents will rise during 2010. If demand remains stable and there is no sharp increase in demand for office space, the amount of space, vacant on the market now will not be absorbed during 2010 and the overall vacancy will drop by just 4 percentage points (from 18% to 14%). Moreover, as the market will be left with only new delivery, which in most cases means shell&core space, and as developers will be oriented towards large occupiers, we expect that they will be prepared to offer additional incentives to tenants, which will result in a further decline in rents (by up to 5%).

Vacancy Rates in Geographic Submarket



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