

GENERAL OVERVIEW

In 2009 Moscow’s warehouse market was significantly affected by the economic crisis. The nature of the market changed dramatically, with the balance shifting quickly in favour of tenants. In 2009 the era of huge speculative warehouse development came to an end and many major planned projects were put on hold.

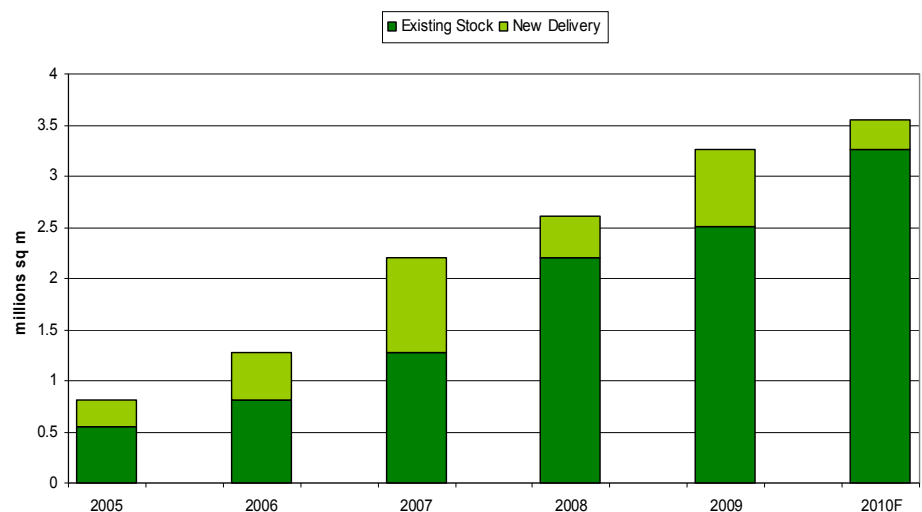
Prior to the economic downturn, the Moscow region’s logistics market was rapidly expanding with many huge speculative schemes delivered to the market during the previous few years. Speculative leasing from local logistics services providers fuelled speculative development across the whole country, not just in Moscow region.

However, from the beginning of 2009 a massive market shift took place: vacancy rates grew sharply throughout the year, exerting strong downward pressure on rental rates. This fall may only now be ending, with the first signs of rental rate stabilization visible on the market. Nevertheless, economic conditions remain fragile in Russia, directly affecting the key fundamentals of warehouse development and demand for quality warehouse space.

From 3Q 2008, construction activity slowed significantly as developers faced problems with financing. Over the previous few years, the growth of warehouse rental rates was fueled by aggressive speculative leasing from local groups and very low vacancy rates, which guaranteed developers good returns on their projects. Development was also spurred by exceptionally attractive financing for the biggest development schemes. Those enticements are now gone and unlikely to return in the near future.

With vacancy rates increasing across Moscow region, landlords are not only competing against each other but also against offers for sub-lease. With the increase in available warehouse options, tenants became very selective in 2009. The primary aim among all quality warehouse users in 2009 was to achieve cost savings on their real estate premises – in all occupancy costs, not just in rent paid.

Warehouse and Logistics Space in Moscow Region



Change from previous quarter

	Q2 09	Q3 09	Q4 09
Total Stock	↑	↑	↑
Vacancy Rate	↑	↑	↑
Rental Rates	↓	↓	→
Prime Yields	↑	→	→

- Vacancy rates rose from 3.5% at the end of 2008 to 16.9% at the end of 2009 as user demand dropped
- Large-scale speculative development will not return for at least 2 to 3 years
- Pipeline of future supply fell as sources of financing closed off
- Users sought opportunities to reduce all occupancy costs, not just rent
- Many groups have initiated aggressive “rightsizing” strategies as all companies now understand the risks associated with aggressive speculative leasing

Supply

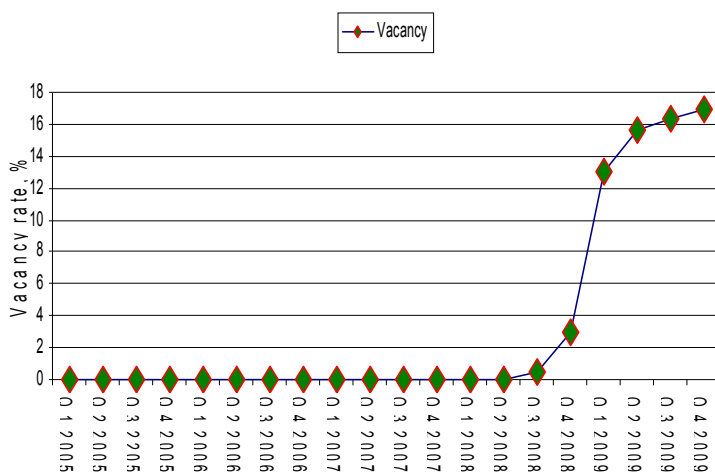
In 2009 several international quality projects were delivered to the market. The total stock of quality warehouse premises in Moscow region is slightly over 3.2 mln sq m. The total delivery in 2009 was 746,000 sq m, more than many expected at the beginning of the year. 374 000 sq m was delivered in H1, and 372 000 sq m in H2.

The future supply of high-quality premises will be limited in 2010-2011, and only well-positioned projects will be competitive. Marginal new schemes will be difficult to let as tenants have a wide range of good warehouse options to choose from.

Historically, warehouse projects in Russia are often delayed from 6 to 18 months for various reasons, including financing, infrastructure, permits etc. Thus the future delivery pipeline, limited though it is, remains very uncertain. We expect that approximately 250,000 – 300,000 sq m of new quality inventory will be delivered to the market in 2010. However, the warehouse sector is heavily reliant on long-term financing during the development process, and weak demand, increasing vacancy rates, low rents and a lack of capital are of real and serious concern to potential investors. As a result, no speculative schemes will be implemented unless rental levels reach at least \$120 / sq m / year and vacancy falls significantly. However, investors are now ready to consider build-to-suit and production real estate solutions for secure and well-positioned local and international groups.

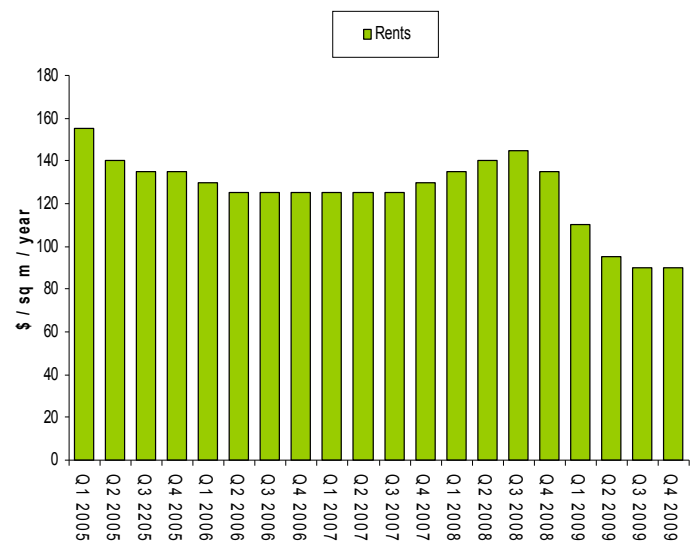
Currently, there are only a few experienced developers on the market who can afford to provide tailor-made real estate solutions on fully serviced land sites. Consequently, there will be limited build-to-suit projects delivered to the market and only the most flexible developers will be able to meet non-standard real estate needs from potential users interested in build-to-suit options.

Vacancy Rates in Moscow Region



Source: CB Richard Ellis

Rental Levels in Moscow region



Source: CB Richard Ellis

Demand and Vacancy Rates

In 2009 many groups initiated aggressive "rightsizing" strategies in face of the large amounts of speculative developed space left vacant as a result of the economic crisis. Occupiers are now looking to utilize less space and increase its efficiency. Many tenants seek opportunities to restructure leases and reduce all occupancy costs, not just rent but also operating costs, parking, utilities, etc. Tenants who leased large blocks of warehouse space at the top of the market are now trying to sub-lease underutilized space – if necessary at lower rents. Others are trying to return this space to their landlords.

Demand for quality warehouse premises in 2009 was very weak and the leasing market deteriorated until mid-summer 2009: only a few deals were transacted in 1H 2009. In 3Q 2009 the pace of leasing unexpectedly picked up with several large transactions for prime warehouses. However, in 4Q 2009 demand again fell with only a few transactions being closed.

Total net absorption of quality warehouse space in 2009 was 505,000 sq m, of which more than 401,000 sq m was in the prime Class A segment. The most active users in 2009 were retailers and Russian distributors. In current market conditions, cost-efficiency rather than growth is most often the reason occupiers move.

Local logistics companies and 3PL-providers, as the most active users of premium warehouse premises, came under huge pressure throughout 2009. Prior to the crisis almost all were leasing warehouse blocks which were greater than their short/medium-term needs. With the onset of the downturn, this aggressive leasing evaporated. While most continue to operate, some are at significant risk of defaulting on their lease obligations.

The vacancy rate sky-rocketed from 3.5% at the end of 2008 to 15.6% in the middle of 2009. The positive net absorption seen in 3Q 2009 saw a slower rise in vacancy to 16.4%, and by the end of 2009 the rate was 16.9%. We expect that the vacancy rate will stabilize in mid-2010 and will then slowly start to fall from 2H 2010. For the next 4 to 5 years the "normal" vacancy rate on the Moscow market will not be less than 6-7%, compared with below 3% prior to the downturn. Nevertheless, this rate will be sufficiently low to encourage further market development, including speculative and build-to-suit projects.

Rental Rates

Rental rates for quality warehouse premises in Moscow region steadily declined through 2009, under severe pressure from weak demand and high vacancy rates. Weighted-average prime warehouse rents in Moscow region fell by 35% compared with pre-crisis levels.

Current prime warehouse rents vary from project to project, but in general were between \$100 - \$105 / sq m / year triple net at the end of 2009. The majority of landlords tried to maintain asking rates, but still made aggressive proposals at initial face to face meetings. In 2009 they became much more flexible in offering incentives to tenants, with many owners considering rouble-denominated leases and shorter lease terms. In particular, developers now place great value on international clients versus local groups and are ready to offer very attractive lease conditions and other incentives to secure these tenants.

We expect that rental rates will stabilize in 2H 2010. However, this does not apply to several marginal developments which will face problems even as the market starts to recover due to poor transportation and access, low-quality construction, high operating costs and asking rents, small parking areas and poor utilities, etc.

Outlook

While the warehouse sector fell sharply in all Russian regions, its recovery will not be so uniform. By the end of 2009, the outlook for Moscow region's warehouse market was more optimistic compared with Russia's regional markets. Nevertheless, Moscow's warehouse market remains very small with limited developments meeting international standards. In the short term, we expect further downward pressure on rental rates as vacancy levels are still very high, but the key economic indicators will improve significantly in 2010, encouraging a return to growth. Already we are seeing the first signs that the decline in the warehouse market is slowing, and we expect stabilization in 2010, even while market fundamentals remain fragile. Risks remain higher in Moscow region than in other European markets, but we expect that there will be more opportunities for developers and investors from 2010 due to the undersupplied nature of the market.

Despite the poor market conditions of 2009, the Moscow market retains substantial development potential in the medium and long-term. In addition, in 2010 the industrial market in Russia will provide excellent conditions for production companies who are looking for opportunities to benefit from the current market lows by setting up production facilities in the country.

2009 Big Box Logistics Market Trends

Tenant / Occupier

- **Market has shifted from a landlord's market to a tenant's market**
- **Most active users currently are retailers and Russian distributors**
- **Occupiers have changed their aggressive leasing strategies**
- **Tenants are looking to utilize less space and increase efficiencies**
- **Tenants are looking to restructure leases**
- **Tenants are looking to reduce all occupancy costs, not just rent**
- **Tenants investigate the market and then renew**
- **Large local users who accounted for large blocks of absorption are now seeking to give back this space**
- **Tenants who leased large blocks of space at the top of the market are now trying to sublease underutilized space even at lower rents and/or attempting to return this space back to landlords**
- **Lease defaults continue but it is difficult to determine the extent due to opacity over commercial terms and actual vacancies**
- **Potential tenants have more warehouse options to choose from than previously**

Landlord / Developer

- **Large speculative development will not return in the medium term**
- **Most major planned projects have been put on hold**
- **Future pipeline is very uncertain**
- **Developers face problems with funding**
- **Vacancy rates vary from project to project, but most developments have at least some vacant premises**
- **Landlords have tried to maintain asking rates, but are offering aggressive proposals upon initial face to face meetings**
- **Landlords have become much more flexible in offering incentives to tenants, with many owners considering rouble leases and shorter lease terms**
- **Developers now realize the value of international clients versus local groups and are ready to offer excellent lease conditions and incentives to secure these tenants**
- **The land market in the Moscow region is almost dead with minimal interest in serviced land at land bank pricing**
- **Experienced developers are now willing to consider build-to-suit**
- **Landlords are keeping commercial terms confidential**

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