

2014

RETAIL MARKET REPORT

Moscow

HIGHLIGHTS

15 shopping centers were delivered in Moscow in 2014. The supply growth of 1,292 thousand sq m (GLA – 689.9 thousand sq m) is an all-time record in the history of professional commercial real estate market.

34 foreign brands entered the Russian market, which is 30% less than the number of newcomers in 2013.

The vacancy rate in operating shopping centers in Moscow has increased to 6% (from 3% at the end of 2013).

Developers of a number of projects are forced to meet the tenants' requests when negotiating contract terms. Tenant companies insist on transition to ruble-denominated lease rates or implementation of fixed exchange rate bands.

RETAIL MARKET REPORT MOSCOW



Julia Sokolova
Shopping Mall Leasing Director,
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“Summarizing the results of the past year, one can confidently conclude that 2015 will be a difficult year for the commercial property market for both the retailers and the developers. The proprietors will have to accept new rules of the market game, which are now in tenants’ favor. While the tenants in turn will have to go through a process of serious reevaluation of efficiency of their businesses including such segments as the purchase of goods, logistics, lease policy, customer services and optimization of all aspects. The proprietors to first make a step on the path of partnership with their tenants will be able to provide their facilities with high-quality pool of tenants and receive guaranteed income; while the tenants, who manage to develop optimal business models, will be able to successfully pass through the following period of recession. Furthermore, the time of crisis is also known as the time of new opportunities. Thus, it is possible that this year we will see a lot of new names on the Russian commercial real estate market”.

Key indicators. Shopping centres*. Dynamics**

Shopping centres stock (total area/GLA***), million sq m	8.98 / 4.74 ▲
Commissioned in 2014 (total area/GLA), thousand sq m	1,292 / 689.9
Scheduled for commissioning in 2015 (total area/GLA), thousand sq m	2,146 / 1,000.7
Vacancy rate, %	6 ▲
Base rents, \$/sq m/year (not including operating expenses and VAT)	
anchor tenants	100–500 ▼
retail gallery tenants****	700–4,000 ▼
Operating expenses, \$/sq m/year	80–260 ▲
GLA in quality shopping centres per 1,000 residents	391 ▲

* The table refers only to high quality, professional retail properties. A professional shopping centre is a standalone building or a group of buildings sharing the same architectural style, concept and under common management, with a total area of more than 5,000 sq m

** Changes compared to 2013 figures

*** Gross leasable area

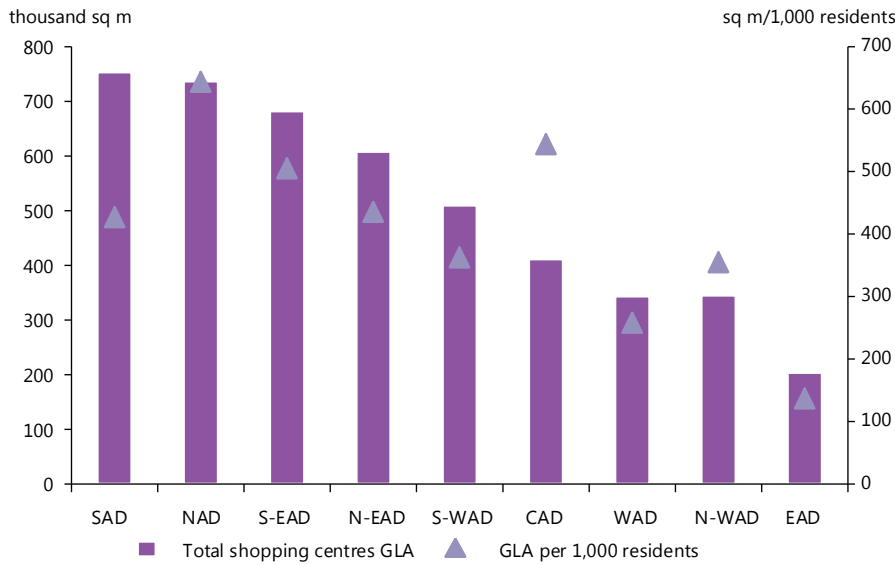
**** Applicable to stores of approximately 100 sq m located on the ground floor

Source: Knight Frank Research, 2015

Key events

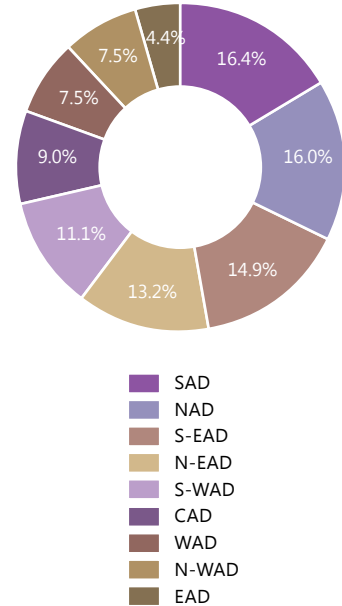
- ♦ In August 2014, Russian President Vladimir Putin signed a decree "On the implementation of certain special economic measures to ensure the security of the Russian Federation", which prohibits import of agricultural and food products from countries that have imposed sanctions against Russia. Most retailers have revised the assortment of their shops, replacing the goods produced in the United States or the European Union with domestic equivalents or products exported from those countries, which have not been embargoed.
- ♦ A number of new large-scale projects of shopping centers were announced for delivery. Among them a SEC at the intersection of Zvenigorod highway and the Moscow Ring Road with a total area of more than 150 thousand sq m (developed by CJSC Don-Stroy Invest); a SEC at the intersection of the Third Ring Road and Zvenigorod highway with a total area of about 260 thousand sq m (developed by

Total supply of shopping centres by districts. Retail space per 1,000 residents



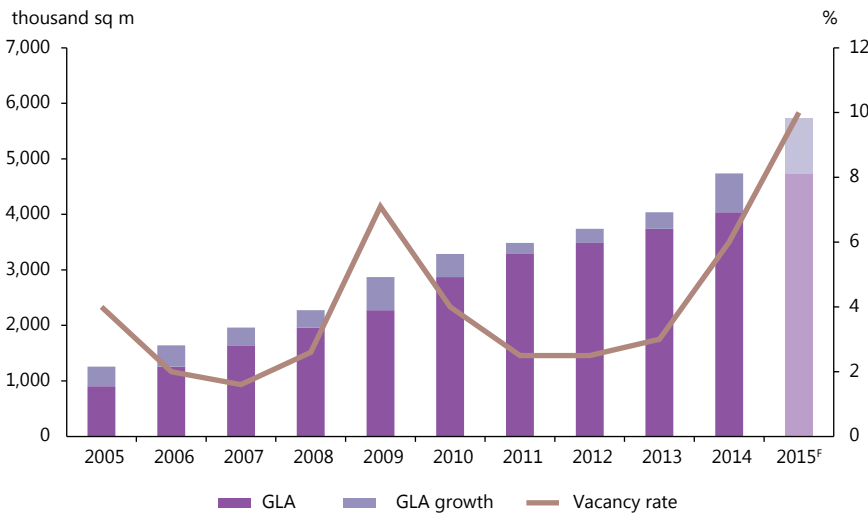
Source: Knight Frank Research, 2015

South Administrative District remains the supply leader of shopping centers on the Moscow market



Source: Knight Frank Research, 2015

Moscow shopping centres supply dynamic



Source: Knight Frank Research, 2015

Supply

In 2014, the total growth of space supply in the shopping centers of Moscow has reached 1,292 thousand sq m (GLA of 689.9 thousand sq m). This growth sets an all time record in the history of professional commercial real estate market. It should be noted that the previous record growth occurred in 2009 and amounted to about 600 thousand sq m of leasable space.

15 retail facilities were delivered on the Moscow market in 2014; in addition, the third stage of the shopping park Otrada in Mitino became operational. The total supply volume at the end of the year amounted to 8.98 million sq m (GLA of 4.74 million sq m). With this, the high-quality retail space stock has grown to 391 sq m per 1,000 citizens.

For several years, South Administrative District remains the supply leader of shopping centers on the Moscow market, accounting for 16.4% of the total retail space of the city by the end of 2014. Meanwhile, Eastern Administrative District had the smallest supply stock (about 200 thousand sq m).

The largest volume of new supply in 2014 fell on the Northern Administrative District with the opening of such large-scale objects as the SEC Aviapark (GLA of 230,000 sq m)

LLC Nordstar Development); SEC June on the NIIDAR territory with the total area of 184 thousand sq m (developed by GC Region) and others.

- A major developer IKEA announced plans for further expansion in Russia: besides announcing delivery of shopping centres in suburban Moscow district of Mytishi and Voronezh, a search for land plots for facilities construction is underway in the cities of Saratov, Volgograd, Perm, Chelyabinsk and Tyumen.
- Among the major M&A (mergers and acquisitions) transactions, one should

take a note of the acquisition of Rossita Company by the Obuv' Rossii Group, previously owning a chain of middle segment shoe shops Rossita and Lisette (83 objects). Another noteworthy transaction is the merger of Tehnosila and Tehnoshoek Companies, which will result in growth of the number of stores under the brand name of Tehnosila.

- A number of operators (Russian subdivision of Metro Group, Detskiy mir, Obuv Rossii) have postponed their plans for an IPO indefinitely due to the complications of macroeconomic situation.

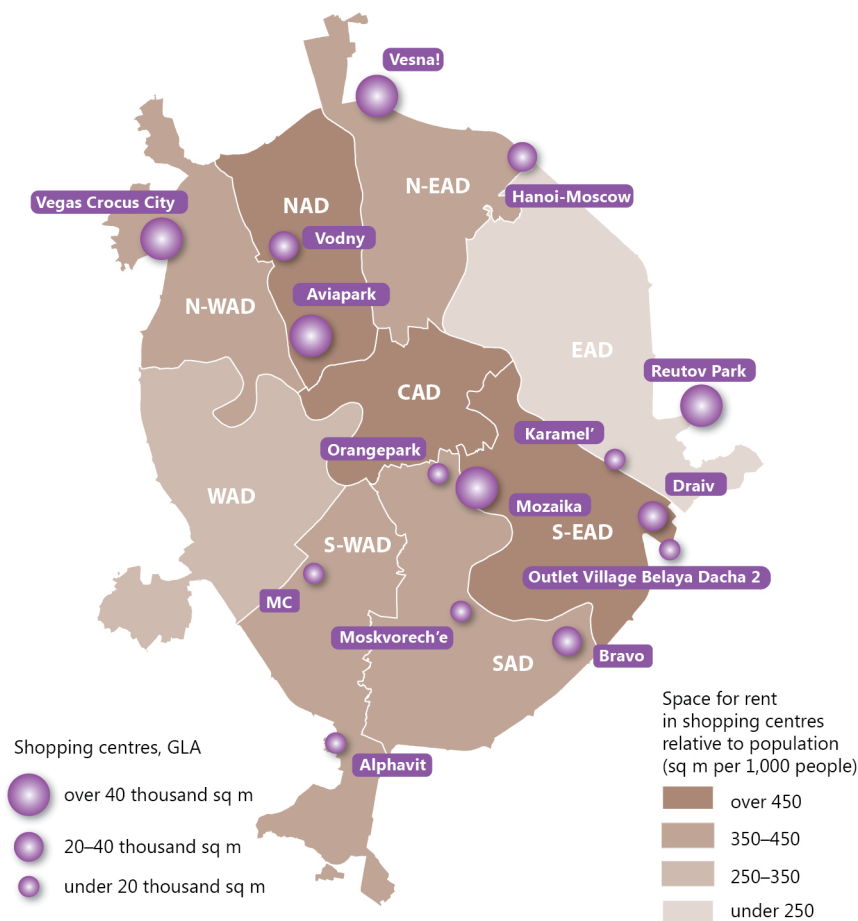
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and SC Vodny (GLA of 32,200 sq m). These for the first time allowed it to overtake the Central Administrative District in terms of high-quality retail space availability (about 640 sq m per 1,000 citizens).

2014 became the landmark year for the Moscow market: about 60% of new supply came from three largest delivered facilities: the SEC Aviapark (GLA of 230,000 sq m), the SEC Vegas Crocus City (GLA of 112,500 sq m) and the SEC Mozaika (GLA of 68,000 sq m).

Specialized retail properties segment continued its growth: the shopping center Tvoy Dom at Ostashkovskoye highway, Leroy Merlin at Novorizhskoye highway and others were delivered. The grand opening of a large wholesale and retail complex Luzhayka and of the wholesale food centre Food City in Q3 are also noteworthy. Despite the fact that such centres are normally not ranked by the market participants as high-quality shopping sites, their role in the development of small businesses and in the formation of the retail sector is becoming increasingly important. At present, implementation of major projects of this format continues in the Moscow region and several cities – multifunctional centre Torzhok (Khimki), showrooms centre Expolon (Moscow), trade and logistics developer centre Nord City mall in Novosibirsk, and so on.

Shopping centres opened in 2014



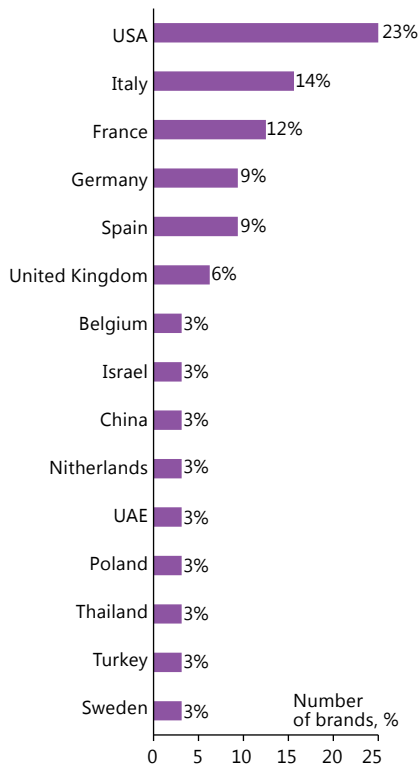
Source: Knight Frank Research, 2015

Largest shopping centres commissioned in 2014

Object	Address	Total area (GBA), sq m	GLA, sq m	Developer
Aviapark	38A Khoroshevskoe Hwy	390,000	230,000	Amma Development
Vegas Crocus City	66 km, MKAD	285,000	112,500	Crocus Group
Mozaika	Bld 3A Kozhukhovskaya 7th St	134,000	68,000	OST-Group and RGI International
Vesna!	Intersection of MKAD and Altuf'evskoe Hwy	126,000	56,000	Central Properties and Alto Assets
Reutov Park	45 Nosovikhinskoe Hwy, Reutov	90,000	41,000	Amma Development
Vodny	5 Golovinskoe Hwy	50,500	32,200	MR Group
Hanoi-Moscow	Bld 1,2 146 Yaroslavskoe Hwy	39,750	31,950	INCENTRA JSC
Draiv	8 km, MKAD	42,000	26,000	TAMP
Bravo	Bld 2, 26 Borisovskie prudy St	24,000	21,000	ABIS Group

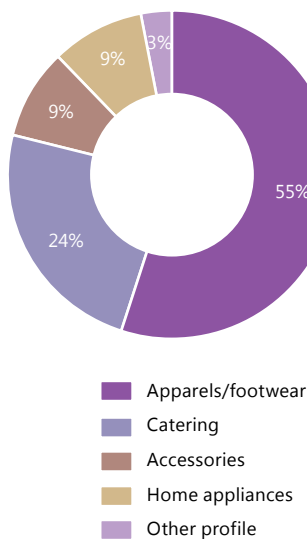
Source: Knight Frank Research, 2015

USA remains the leader in terms of the number of new retail chains market entrants



Source: Knight Frank Research, 2015

"Apparels and footwear" profile companies dominate among the new international operators



Source: Knight Frank Research, 2015

Development is also notable in the entertainment segment: the first in Russia children's park KidZania will be opened in the SEC Aviapark in 2015. Moreover, plans for construction of a specialized children's amusement park Disneyland with an area of 250 thousand sq m at the Nagatinskaya Poyma were announced last year. Another theme park is planned to be built in the Southwest of Moscow, near the Lesoparkovaya metro station.

In addition to traditional shopping centres, opening of several retail parks, located along the main roads of the region, is expected in the near future, for example, Torgovy Park № 1, 007-M7 Retail-park.

This format has barely seen any development in the Moscow Region until now: the companies were mainly focused on development of classical shopping centres, providing maximum profitability. However, positive experience of spontaneous retail parks in conjunction with a number of advantages of such format (lower construction costs, implementation in stages, fast ROI and ease of management) contributed to its active development in the past two years.

Demand

Negative political and economic factors had a significant impact on the development of retail market segment in 2014. The growth rate of retail turnover in Moscow showed a 1.5% decline compared to 2013, while in the whole of Russia this indicator has dropped by 1.7%. According to Rosstat, inflation in Moscow has reached 11.7% – the highest since 2008.

Although operators of different profiles and price segments are affected by the current economic situation unevenly, most retailers have noted a drop in consumer demand, which in some cases manifested itself as a drop in shops' turnout. "Apparels and footwear" segment experienced the most pronounced drop in consumer activity down by 30% for some retailers. Moreover, fashion-operators noted a drop in the average purchase value by an average of 5–7%.

Grocery chains and DIY-stores (mainly low and medium price segments), in contrast, demonstrated growth in the number of visitors. It is also worth mentioning that food embargo had no significant effect on the revenues of these chains: retailers

were able to quickly find substitutes for the goods that became prohibited to import.

Overall, according to the Watcom Group Company, turnout at shopping centers in Moscow in December 2014 was lower compared to the same period (statistics conducted on a weekly basis) in 2013.

Many retailers revised their development plans for the Russian market noting the correction of customer demand. Some brands decided to close the shops in Russia: Sepalla, Esprit, Gerry Weber, River Island, New look. Furthermore, the continuing weakening of the ruble puts considerable pressure on the operators that sell European and American goods, as it leads to the shrinking of business margins.

A significant slowdown in the saturation of new shopping centres with tenants is noticeable: in many objects delivered in 2014, the lease campaigns are still ongoing and there are available premises for the "initial" transaction. Developers, who have launched the brokerage at the early stages of project implementation are benefitting from the current conditions. Moreover, many owners of shopping centers went on with technical opening of their facilities (SEC Mozaika, SC Hanoi-Moscow SC Alfavit and others) with only their anchor tenants (hypermarkets or supermarkets) operating, while the rest of the shopping arcades were filled later.

Following announcements to retire from the Russian market by a number of companies in 2014 and revision of further development plans by many others, including the closure of unprofitable stores, the vacancy rate in shopping centers has grown to 6%.

The situation on the international market has changed: 34 foreign brands entered the Russian market last year – 30% fewer newcomers than in 2013. "Apparels and footwear" segment developed most rapidly: new stores were opened by Italian, French and Spanish brands. USA remains the leader in terms of the number of new retail chains market entrants: shops of such well-known brands as Crate & Barrel, Magnolia Bakery, Hooters and others opened in Moscow.

Moreover, a number of international companies such as Longchamp, Burberry, Jennyfer and others that have previously operated as franchises announced decision to start independent development in Russia.

One of current trends in trade industry is the strive of retail chains to improve efficiency, increase profitability of retail outlets. To

this end, the companies optimized internal processes, implemented re-branding, and so on. For example, Azbuka vkusa has introduced two new formats last year: a minimarket AB Daily and the average price segment supermarket AB Market; X5 Retail Group has created a chain of shops under the brand VoentorgPyaterochka, Mango has created a large-format store Mango Megastore, as well as a shop in oversize segment – Violeta by Mango.

Commercial terms

Thanks to the highly competitive market environment, retailers feel freer in the choice of facilities for their stores considering only the best shopping centers of the capital with the highest traffic. As a result, projects' developers are forced to meet the tenants' requests when negotiating contract terms, providing them with significant discounts (for example, the so-called step-rent – a discount from the base rental rate for the first years of work followed by its gradual growth), increasing the terms of lease vacations and so on. The practice of linking the discount rate to the occupancy of the facility is also in place. On average, market rental rates have dropped by 15–20%.

Rental rates in modern shopping centres in Moscow, 2014

Profile	Fixed rental rate*, \$/sq m/year	The share paid based on turnover, %
Hypermarket (>7,000 sq m)	100–250	1.5–4%
Urban hypermarket (3,000–7,000 sq m)	200–350	2–4%
Supermarket (1,500–3,000 sq m)	250–900	3–6%
DIY (>5,000 sq m)	200–350	4–6%
White & Brown (1,500–3,000 sq m)	150–350	2.5–5%
Sporting goods (1,500–7,000 sq m)	150–300	4–8%
Goods for children (1,000–2,500 sq m)	200–400	8–12%
Apparels (50–300 sq m)	600–2,200	8–16%
Footwear (50–300 sq m)	900–2,500	10–16%
Accessories (10–70 sq m)	2,200–4,000	11–14%
Movie theatres	150–250	7–12%
Entertainment centre (100–1,500 sq m)	200–400	8–12%
Entertainment centre (2,000–5,000 sq m)	100–200	4–7%

* Excluding operating expenses and VAT (18%)

Source: Knight Frank Research, 2015

When renegotiating or entering into new contracts, the tenant companies insist on transition to ruble rental rates or fixed exchange rate band. Moreover, the vast majority of developers are ready to switch to ruble rates as well. Presently, retailers

are willing to terminate (if the contract terms permit) leases with proprietors, who do not make concessions on commercial terms in the view of continuous foreign currency exchange rates growth and decline in returns.



SEC Kuntsevo Plaza, 19 Yartsevskaya St

Largest shopping centres scheduled for opening in 2015

Object	Address	Total Area (GBA), sq m	GLA, sq m
Columbus	140 Varshavskoe Hwy	277,000	140,000
Zelenopark	Leningradskoe Hwy, 17 km from MKAD	140,000	110,000
Riv'era	16–18 Avtozavodskaya St	260,100	91,200
Mari	10 Porechnaya St	135,000	50,000
Kuntsevo Plaza	19 Yartsevskaya St	245,000	65,000
Slavyanka	3 Slavyanskiy Blvd	136,600	61,818
Polezhaevskiy	Bld 1, 33 Khoroshevskoe Hwy	130,000	50,000
RIO Rumyantsevo	Kievskoe Hwy, 1.5 km from MKAD	70,000	45,000
Yugo-Zapad	Intersection of Vernadskiy Ave and Pokryshkina St	70,000	40,000
Centralny Detsky Magazin na Lubyanke	Bld 5 Teatral'ny passage	60,500	35,240

Source: Knight Frank Research, 2015

Forecast

In 2015, more than 20 commercial facilities have been announced for delivery in the Moscow region. Among them such large-scale ones as the SEC Columbus (GLA of 140,000 sq m), the SEC Kuntsevo Plaza (GLA of 65,000 sq m), the SEC Mari (GLA of 50,000 sq m) and others. In the case that the announced projects will be delivered, the supply growth may exceed the record figure of 2014, amounting to about 1 million sq m of leasable space. However, current economic situation is most likely to greatly reduce this figure.

In the coming year, retailers will continue to develop with caution, considering the best deals from developers and analyzing efficiency of each store, getting rid of unprofitable sites. Many companies have already announced plans to revise their expansion on the Russian market, which applies to both federal and international retailers. Moreover, last year we witnessed a 30% drop in the number of international brands entering the Russian market. This trend will persist in 2015: our market is too unstable and unpredictable for European and American brands. However, the coming year may witness growth in the number of international brands coming from Asian markets, such as Turkey. It should be noted that substitution of brands that have left the Russian market will be slow and incomplete, resulting in vacancy rates growth in the shopping centers of up to 10%.

Economic instability, difficulty in obtaining financing, as well as its high cost may affect the delivery of new projects. Already in 2014, the developers of shopping facilities that were in delivery stage, revised their plans and postponed the opening dates. A significant growth of lending rates calls into question feasibility of a project and justifiability of its further implementation. The share of "frozen" objects, as well as the number of projects cancellations at the design stage are likely to grow in 2015. Furthermore, a change of ownership is possible for some projects under construction.

Changes in buyers' consumer preferences may also become an obstacle to the development of the retail market. The main target group of professional retail facilities is middle class, which has only recently began to take shape in Russia. This share of population is most vulnerable: as prices rise, the wages "do not catch up" to the inflation. Already in Q4 2014, we witnessed growth in retail prices in grocery chains, while for "Apparels and footwear" segment the average price growth was 5–7%, in some cases – up to 15%. Further growth in retail prices of goods in different categories is expected in 2015. Such development is not only the consequence of current economic situation, but also of the downward trend in sales: for some operators turnover may shrink by 30% in H1 2015.

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