COMMERCIAL REAL ESTATE MARKET OVERVIEW

2009

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Content

Summary

2 mln. sq. m. of office space were commissioned in the office real estate market in 2009. 40% of this space was class A, 60% was class B. Therefore, the overall supply of good quality office space in new and reconstructed class A and B buildings is estimated at 10 mln. sq. m.

The main trends in demand for office space in 2009 are the following: demand for lease and sale decreased considerably, small fit out offices remain the most sought-after; demand for purchase of office assets has been growing since summer and the share of requests for lease of bigger offices is also growing which shows that asking prices and rental rates are more in line with expectations of potential buyers and tenants. Seeing the reduced rates the potential tenants seek to sign long-term agreements. By the end of the year, demand for lease and sale of offices intensified (including investment demand) but the absorption rate was lower than new supply commissioning rates.

The rental rate decline in H1 2009 was the most dramatic and it decelerated substantially by mid-Q3 2009. By fall 2009 the rates reached relative stabilization and remained at the following levels till the end of the year: rents for class A offices vary between $450-$900 per sq. m. per year, the average rent in B+ offices varies between $350 and $600 per sq. m. per year and in class B- offices - between $250-$400 per sq. m. per year (exclusive of VAT and OPEX). Operation expenses amounted to $75–$110 per sq. m. per year in class A offices, $50-$80 in class B+ offices and $35-$50 in class B- offices.

Despite some recovery of demand for high-quality office space in the last months of 2009, the main office market trends remain negative: delivery of many properties is postponed, implementation of new big projects is either put on hold or cancelled. Blackwood's experts believe these trends will remain in force in the first six months of 2010. Further growth of demand in the commercial real estate market is possible provided the prices remain at the current level and there's no economic crash.

In 2009, 950,000 sq. m. of retail space were delivered in Moscow, the leasable area being 530,000 sq. m. Therefore, as of the end of 2009, the aggregate supply of high quality retail space amounted to 4,9 mln. sq. m., the retail space is approx 2,6 mln. sq. m. As a result, there were 248 sq. m. of retail space per 1,000 people in Moscow.

Throughout 2009, demand for retail space remained unstable. Starting from the end of 2008 and during the first six months of 2009, the activity of retail operators was at a low level which resulted in decreasing demand for space in shopping malls and in the street retail segment. However, the retail activity increased in autumn: the number of transactions grew up and as a result, the rental rates stopped falling (the rental rates even rose in some properties and shopping galleries) and vacancy rates declined.

Seeing stabilization of rental rates both in retail centers and in the street retail segment, more optimistic market players said the market had hit the bottom and that the retail sector would soon grow up.

Since no new projects were announced in the retail market in 2009, we believe the market will face new deficit of high quality supply as soon as the crisis is over which will result in new growth of rental rates. However, it can only be expected in one year and a half – two years.

In 2009, 8 hotels (approx 1,000 rooms) and suites in the Federation Tower operated by the Global Hyatt Corporation were commissioned. Besides, the first capsule 66-room hotel called Air Express was opened at Sheremetyevo airport (Khimki, Moscow Region).

In January-December 2009, the occupancy rates in Moscow hotels fell 28% on average versus the corresponding period of 2008 reaching 50%. Partially, the occupancy rates decline was caused by decreasing tourist flows. Another reason was that people reduced periods of stay and chose alternative means of accomodation during their stay in Moscow.

The average ADR amounted to 4,050 rubles, 15% less than in 2008. ADR in the high-cost segment saw the biggest decline, 26%, reaching 6750 rubles. The decline in ADR in the mid-cost segment was 14,5% (3,180 rubles). ADR in the low-cost segment rose 14% amounting to 1,780 rubles.

In a short-term perspective, the average occupancy rates of the Moscow hotels will remain at 55-60%. We don't expect any further decline in average sale prices. However, the prices are likely to return to the level reached prior to the crisis only by the end of 2011 – beginning of 2012.

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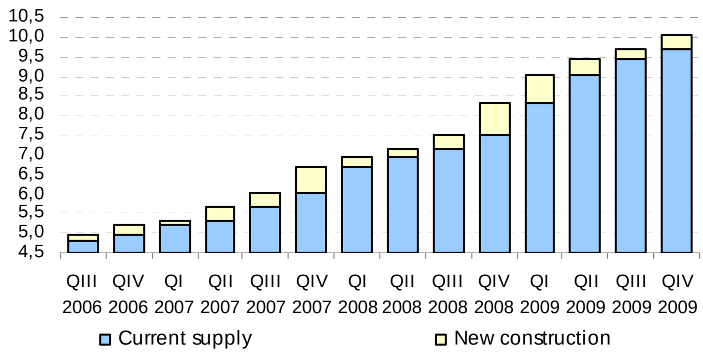
Supply

2 mln. sq. m. of office space were commissioned in the office real estate market in 2009. 40% of this space was class A, 60% was class B. Therefore, the overall supply of good quality office space in new and reconstructed class A and B buildings is estimated at 10 mln. sq. m.

Vacancy rates kept growing throughout 2009, some major office centers were 100% vacant at the moment of commissioning. As of the end of 2009, the vacancy rates in class A offices reached 20% and in class B offices – 25-28%. Most vacant offices can be found in the shell&core supply segment.

Supply volume dynamics, mln. sq. m



Source: Blackwood research

Some properties put into operation in 2009

Class	Name	Address	Total area, sq. m.
A	«Eseninskii» and «Strochenovskii» mansions	B. Strochenovskii per., 25	5 900
A	Nordstar Tower	Horoshevskoe sh., 2-20 V	140 000
A	White Square Office Center, A, B,C	Lesnaya ul., vl. 11-15	100 000
A	Victory Plaza	Viktorenko ul., d. 3	31 000
A	Dvintsev	ul. Dvintsev, dom 12, korp. 1	58 000
A	Principal Plaza	prosp. 60-letiya Oktyabrya, 12	33 400
A	Svyatogor VI	ul. Letnikovskaya, d. 10, str. 4	23 000
A	Westarn Gate	Belovezhskaya ul., vl. 21	50 000
A	Business Centre	Arbatskaya pl., d. 1	15 000
A	«Monarh-tsentr»	Leningradskii prosp., vl. 31, str.2,3	167 900 (office space 78 000)
B+	Business Centre	Varshavskoe sh., vl. 118 A	49 884
B+	Nagatino-i-land	Avtozavodskaya ul., 23	114 500
B+	«Korpus Knopa», 1 phase	Varshavskoe sh., d. 9 str. 1	15000
	Espace (Kosinskaya Plaza)	Kosinskaya ul., d. 9, vl. 21	111 700
B	«Rumyantsevo»	Kievskoe sh., vl. 1	161 000
B	«Legion III», 2 phase	Kievskaya ul., d. 3-7	37 000
B	«Yuzhnyi port», 2,3 phases	2-i Yuzhnoportovyi pr., vl. 12	30 000
B	«Burevestnik»	3-ya Ryabininskaya ul., d. 17	29 100
B	Solutions, bld. 1	Varshavskoe sh., vl. 150, 156	24 600
B	Brent Siti, 2 phase	Dubininskaya ul., 57	28 300 (office space 11 600)
B	«Pavlovskii», 2 phase	Pavlovskaya ul., d. 7, str. 2	12 500

In 2009, the market showed the following trends:

- Growing vacancy rates: many new offices come into the market while demand remains low;
- The sub-lease segment, with over 200 thous. sq. m. of offices, also remains an important source of vacant supply;
- Supply volume is growing as offices are vacated upon expiration or termination of lease agreements.

The credit situation remains challenging which makes many developers either reconsider their plans, reschedule delivery dates of the office centers under construction, put on hold or change their commercial office projects in the pipeline.

Over 2009, the market has been showing the following trends:

Supply volume is growing, among other things, because of growth in vacancy rates as offices are vacated upon expiration or termination of lease agreements;

The sub-lease segment, with over 200 thous. sq. m. of offices, also remains an important source of vacant supply;

Still, we expect numerous office centers to be commissioned in 2009 and the overall new supply will reach approx 2 mln. sq. m.

The credit situation remains challenging which makes many developers either reconsider their plans, reschedule delivery dates of the office centers under construction, put on hold or change their commercial office projects in the pipeline.

Source: Blackwood research

Demand

In 2009, demand for lease and sale of high quality offices remained weak, its volume and structure decreased substantially in comparison with the same period prior to the crisis.

The incoming requests in 2009 were distributed in the following way: 74% of the requests were for lease and 26% - for purchase of office premises.

As far as the demand for lease of office premises in terms of class of buildings is concerned, C class offices enjoyed the highest popularity (38% of the incoming requests). Its share grew more than 30% versus 2008 while the share of class A offices declined 40%, from 55% to 15%.

In 2009, the pattern of demand for lease of office premises in terms of size didn't undergo any serious changes, the smallest office blocks remain the most popular. At the same time, the share of requests for lease of the biggest offices also increased from 15% to 18% which shows that demand for office of bigger size is growing as landlords decrease rent.

In the pattern of demand for purchase of office space, B-offices are again the most sought-after, 81% of all the incoming requests, its share grew 35% versus last year.

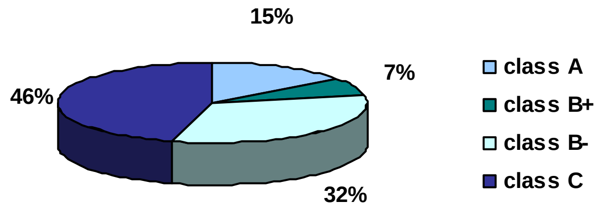
Despite considerable fluctuations in 2009, the pattern of demand for purchase of office space in terms of size was similar to that of 2008: clients were most interested in the biggest offices from 501 to 1,500 sq. m. and over 1,500 sq. m.

One third of the overall number of requests is for the smallest offices (+27% versus last year when the most sought after were the biggest offices). The share of requests for the biggest blocks decreased from 37 to 27%.

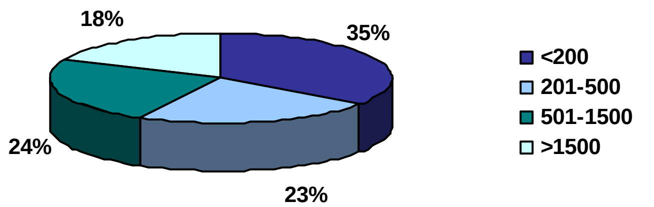
Therefore, we see the following trends in demand for office space in 2009: demand for lease and sale decreased considerably, small fit out offices remain the most sought-after; demand for purchase of office assets has been growing since summer and the share of requests for lease of bigger offices is also growing which shows that asking prices and rental rates are more in line with expectations of potential buyers and tenants. Seeing the reduced rates the potential tenants seek to sign long-term agreements. By the end of the year, demand for lease and sale of offices intensified (including investment demand) but the absorption rate was lower than new supply commissioning rates.

Renegotiation became a common practice in commercial leasing in 2009. Many companies looked to optimize lease expenses by moving into cheaper offices. Demand for lease and sale of high quality offices remains weak, its volume and structure decreased substantially in comparison with the same period prior to the crisis.

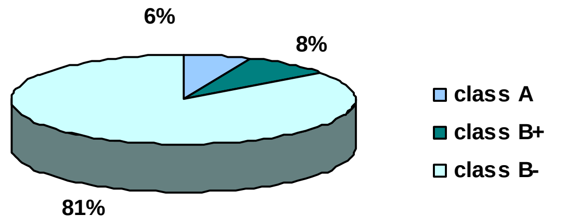
Office premises demand pattern with breakdown by building class. Rent



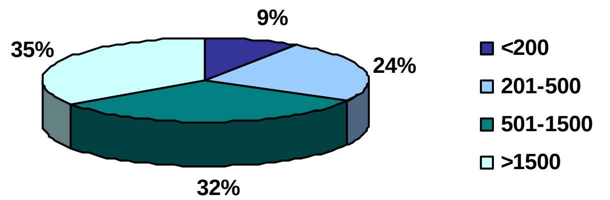
Office premises demand pattern with breakdown by metric space. Rent



Pattern of office premises purchase demand with breakdown by building class



Pattern of office premises purchase demand with breakdown by metric space



Source: requests to Blackwood in 2009

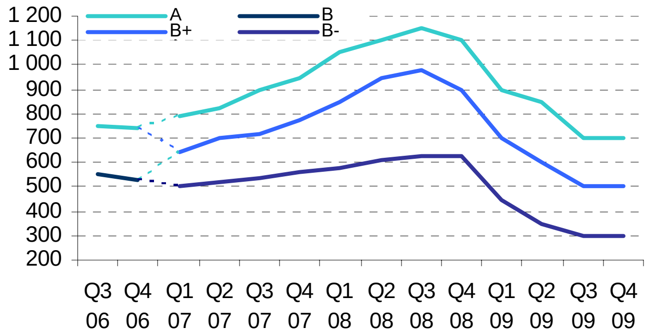
Rental rates and sales prices

In 2009 the price trends in the commercial real estate market remained negative as rents in class A offices fell 30-35%, in class B+ offices - 35-40% and in class B- offices - 40-45%.

The rental rate decline in H1 2009 was the most dramatic and it decelerated substantially by mid-Q3 2009. By fall 2009 the rates reached relative stabilization and remained at the following levels till the end of the year: rents for class A offices vary between $450-$900 per sq. m. per year, the average rent in B+ offices varies between $350 and $600 per sq. m. per year and in class B- offices - between $250-$400 per sq. m. per year (exclusive of VAT and OPEX). Operation expenses amounted to $75–$110 per sq. m. per year in class A offices, $50-$80 in class B+ offices and $35-$50 in class B- offices.

Sale prices in 2009 also continued to fall: prices of class A offices vary between $3,000 and $10,000 per sq. m., prices of B+ class offices are between $2,500-$7,000 per sq. m. and prices of B- offices are between $1,500-$4,000 per sq. m. Still, the price could be negotiated and many landlords were willing to decrease substantially the initial price, in some cases, discounts reached 15-30% and even more.

Office space weighted average rental rates dynamics, $/ sq. m



Source: Blackwood research

We estimate that most transactions in 2009 were made within the following price range:

Lease: class A - $400-$700, class B - $200-$400 per sq. m. per year. Purchase: class A - $3000-$4500, class B - $1500-$2500 per sq. m.

Landmark events and transactions of 2009

Most lease transactions in 2009 involved office space up to 10,000 sq. m. Several companies acquired properties for their own needs which, considering substantial sale price reduction, was more cost-efficient than signing a long-term lease.

Investment deals in 2009 were few and far between.

Major transactions of 2009

Buyer/Tenant	Object	Space, sq. m	Address	Transaction type
Interros	Domnikov	130 000	Ak. Saharova prosp.	asset acquisition
n/a	Espace	112 000	Kosinskaya ul.	asset acquisition
Evans Randall	Silver City	41 650	Serebryanicheskaya nab.,29	asset acquisition
«Bol'shoi gorod», bank «Razvitie-Stolitsa»	Severnoe Siyanie	38 000	ul. Pravdy, d. 26	asset acquisition
«Progressivnye investitsionnye idei»	Group of buildings OAO «Mosenergo»	36 000	Sadovnicheskaya ul., Raushskoi nab.	asset acquisition
Inter RAO EES	LUCh	35 000	B. Pirogovskaya ul.	building acquisition
Siemens	Legion II	29 000	B. Tatarskaya ul., 13	building acquisition
MMVB	Elohovskii	17 078	Spartakovskaya ul.	building acquisition
Sportmaster	Aviator	16 700	Kochnovskii per., h. 4	lease
Rosnano	Principal Plaza	16 200	Prospekt 60-letiya Oktyabrya, 12	building acquisition
Novatek	Business Centre	12 700	Udal'tsova, 2	building acquisition
Olimpstroi	Solutions	11 000	Teatral'naya alleya, d. 3, str. 1	lease
Unilever	Marr Plaza	9 350	ul. Sergeya Makeeva, vl. 13	lease
GazPromTsentrRemont	Gas Field	8 550	Obrucheva ul., 27	lease
Holding MRSK	Office Building	8 087	Ulanskii per., 26	lease
Aeroflot	Midland Plaza	7 000	Staryi Arbat ul.	lease
RZhD	Mansion *	6 200	ul. Kazakova	lease
Sandoz	City Tower	4 700	Krasnopresnenskaya nab.	lease
Alcatel	Lefort	4 500	Elektrozavodskaya ul.	lease
Retail Company	Domodedovo*	3 800	Domodedovo	lease
Halliburton International Inc.	Dvintsev	2 600	Dvintsev ul., 14	lease

*** - Blackwood transaction**

Landmark events and transactions of 2009:

- *Many developers have to reconsider their development strategies and restructure their portfolios putting most projects on hold and focusing on high liquidity projects close to completion:*

⇒ RGI Moscow developer company decided to put on hold all its projects at an initial stage (80% of the portfolio) to finish the implementation of the key project, a retail center in Tsvetnoy Boulevard;

⇒ Midland Development decided to freeze the development of 1 mln. sq. m. for one year and complete the construction of Diamond Hall business center (61,5 thous. sq. m.) and Parus retail center (35,5 thous. sq. m.) financed by Sberbank;

⇒ Developer Horus Capital sells over half of its portfolio. Currently, its assets total 200 thous. sq. m.;

⇒ The construction of Nagatino-i-land will last till 2013;

⇒ The third and the fourth construction stages of the Aurora Business Park will be completed in the end of 2012 and 2014, respectively;

⇒ European Bearing Corporation (EBC) cancelled its plans to develop the Galileo business park in the territory of Moscow Bearing Factory. The redevelopment project was estimated at $490 mln.;

⇒ Development of the Victory Park MFC in Vasilisy Kozhinoy Street (136 thous. sq. m., its investors are Rubin Moscow Television Factory and Sozdanie Investment Group) is rescheduled from 2010 to 2015;

- *Major banks continue to accumulate pledged office assets:*

⇒ Sberbank – part of the City of Capital project in the Moscow City IBC;

⇒ VTB Bank - 51% of the shares of Sistema Hals Company, Nordstar Tower, pledge of 80% of the Imperia Tower (MosCityGroup);

⇒ Vnesheconombank (VEB) bank – the Novinsky Passage BC, assets of Globex bank;

⇒ Alfa Bank – the Federation Tower, Mirax Plaza, Northern Light (sold to Evans Randall fund), HQ of Kopernik Group at Krasnaya Presnya 22. Since state-owned banks are major creditors of the construction sector most of them became important players in the commercial real estate market by the end of the year;

- *Changes in the Moscow City IBC:*

⇒ Construction of several landmark buildings was cancelled: the Russia Tower (the developer is ST Towers), the Moscow City Hotel (AFI Development), the City Palace skyscraper with a wedding palace;

⇒ The West tower underwent a height reduction (it was initially to rise to 62 storeys) and will have the same height as the already operating East tower.

Major projects announced in 2009

Developer/ Investor	Name	Address	Space, sq. m
BIN group	Hotel, business and cultural center	Varshavskoe highway., h. 170	1 000 000
Coalco	BC on the territory of machine-building factory "Iskra"	Leningradskii prosp., 35	200 000
ZAO «Tantema»	Apartment and business complex	Novyi Arbat, h. 36/9Z	186 000
n/a	Multifunctional complex in Moscow City	1 Krasnogvardeiskii pr., vl. 9	179 612
n/a	Multifunctional complex «Khanoi - Moscow»	94 km MKAD	158 000
n/a	multifunctional complex «Media-centre»	Shosseinaya str., h. 4 D, territory of printing plant «Printing compels «Pushkinskaya ploschad»	123 500
Bosh	office complex	Shremet'evo-2 area	94 000
«Kraun Investsments»	multifunctional complex	Ozerkovskaya emb., h. 22-24	78 647
Lotte Group	Multifunctional complex	Profsoyuznaya ul., vl. 65	60 000
OAO «VIP-Center»	Hotel and business complex	Sadovnicheskaya str., h. 31	51 600
OAO Lukoil	Administrative building	Ulanskii per., vl. 5-7, str. 2, vl. 7-9	44 800

Source: Blackwood research

Forecast

Despite some recovery of demand for high-quality office space in the last months of 2009, the main office market trends remain negative: delivery of many properties is postponed, implementation of new big projects is either put on hold or cancelled. Blackwood's experts believe these trends will remain in force in the first six months of 2010. Further growth of demand in the commercial real estate market is possible provided the prices remain at the current level and there's no economic crash.

We don't expect the rental rates and sale prices to grow as the aggregate volume of vacant space is still very high (approx 2 mln. sq. m.).

As far as the price situation is concerned, it will remain stable throughout the first half of the year, insignificant fluctuations are possible in different business districts.

People will be most interested in the best in class projects, close to completion, with a carefully elaborated concept, in prime location. The share of preliminary agreements for space in office centers under construction will remain minimal.

Shell&core premises located outside of the city center, especially class B- offices, will be the least popular.

1 mln. sq. m. of office space will come into the market in 2010.

Some projects scheduled for commissioning in 2010

Класс	Название	Адрес	Общая площадь, кв. м
A	«Domnikov»	Akademika Saharova prosp., d. 30	132 000 (office space 70 000_
A	«Vivaldi Plaza»	Kozhevnicheskaya, d. 8/4	100 600 (office space 68 000)
A	Diamond Hall	Olimpiiskii pr-t vl. 12/16	61 500 (office space 35 000)
A	City Tower, phase II	Krasnopresnenskaya nab.	50 000
B+	SK Plaza	MKAD and Dmitrovskoe sh. crossing	40 000 (office space 20 000)

Supply

In 2009, 950,000 sq. m. of retail space were delivered in Moscow, the leasable area being 530,000 sq. m. Therefore, as of the end of 2009, the aggregate supply of high quality retail space amounted to 4,9 mln. sq. m., the retail space is approx 2,6 mln. sq. m. As a result, there were 248 sq. m. of retail space per 1,000 people in Moscow.

We should say that the share of commissioned shopping centers was higher in 2009 than in 2008. If in 2008, it was only one third of the anticipated number, this index reached 60% in the end of 2009 as the market saw delivery of the properties announced in 2008 or earlier but which were close to completion in early 2009.

We should also name another important characteristic of the new supply in 2009. At the moment of commissioning, only part of the shopping gallery and some anchor tenants were operating. In 2009, the share of the operating sections in recently opened shopping centers was usually 30-50% of the overall retail space due to financial difficulties of retail operators in Moscow and regional cities.

We see that shopping malls were not launched regularly during the year as only one big retail center was commissioned in H1 2009, 9 retail centers - in H2 2009, 6 of them – in December.

Professional retail centers opened in 2009, Regions

Town	Name	Total area, sq. m	Developer
Rostov-na-Donu	Zolotoi Vavilon	75 000 / 52 000	Patero Development
Omsk	MEGA	120 000 / 80 000	OOO «IKEA MOS»
Krasnodar	SBS Megamoll (3 phase)	160 000*/ n/a	SBS Development
Lipetsk	Moll	50 000 / 30 000	RTM Development
Belgorod	Rio	45 000 / 28 000	Tashir
Irkutsk	Jam Mall	30 000 / 21 000	HCMG
Novorossiisk	Krasnaya ploschad'	44 000 / 24 000	Ramo
Rostov-na-Donu	Megamag (1 phase)	40 300 / 25 000	Edinstvo
Ekaterinburg	Alatyr'	77 000 / n/a	OOO TEN
Kaluga	SanMart	47 000 / 35 000	ZAO Tsentrum Park Kaluga

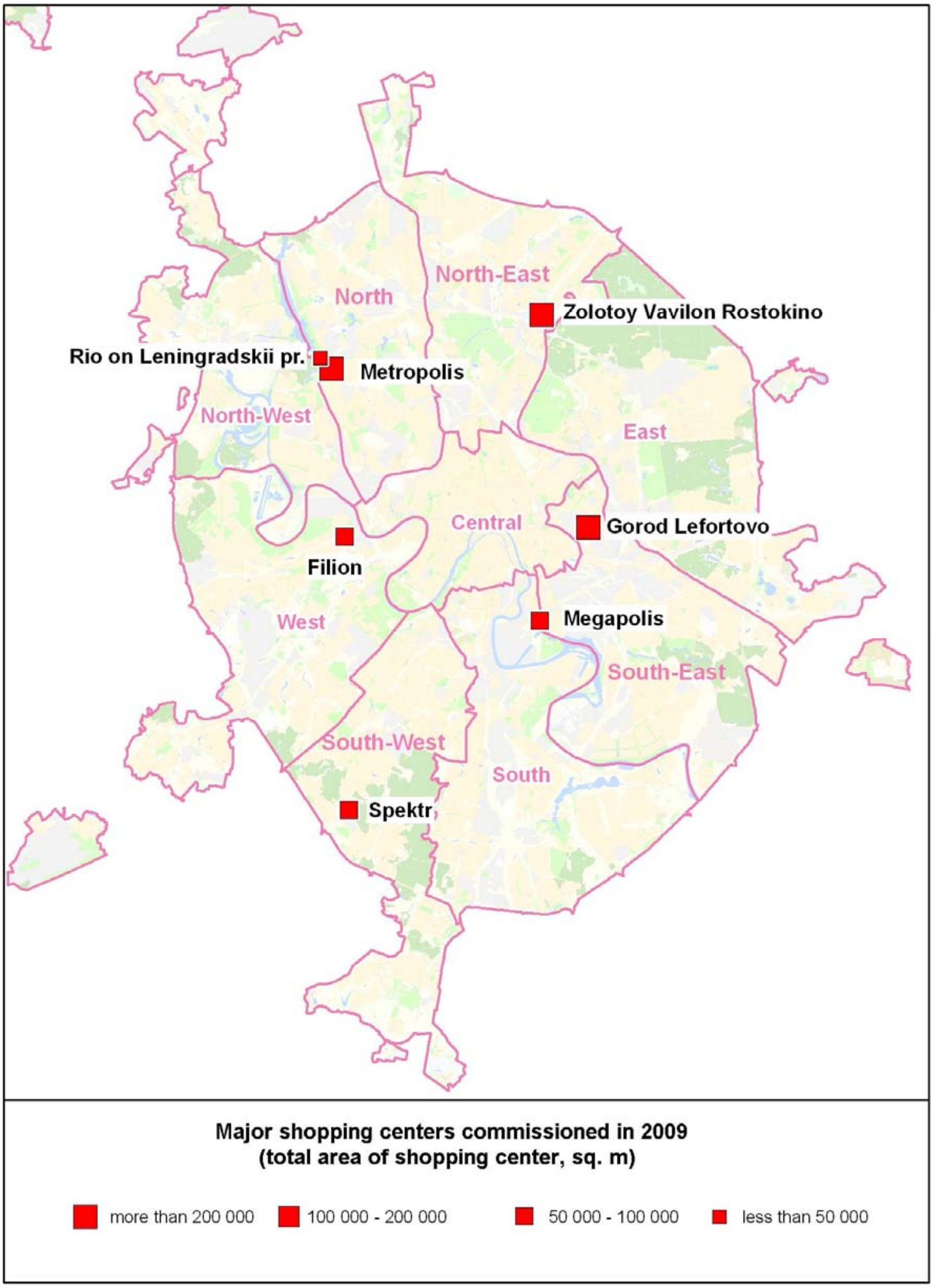
** - Total area of all phases*
Source: Blackwood research

Professional retail centers opened in 2009, Moscow

Name	Total area/ retail space, sq. m	Developer	Main tenants
Metropolis	205 000 / 80 000	Capital Partners	Anchor tenants: «Perekrestok», «M.Video», «Stokmann», «Sportmaster», «Snezhnaya Koroleva», «Marks & Spencer», «Kinostar De Luxe».
Megapolis	72 000 / 44 000	n/a	Anchor tenants: «Carousel», «Detsky mir» and «Formula Kino», «Game Zone» entertainment center.
Spektr	56 400 / 30 000	Investment Group «Z_Build»	Anchor tenants: «Carousel», «M.Video» and «Karo film» and «Star Galaxy» entertainment center.
Na Begovoy	19 700 / 10 650	«DS-Development»	«Alie Parusa» food supermarket, «Eldorado» appliance store
Filion	87 600 / 55 000	«Rubin Development»	«Carrefour» grocery supermarket, «Decathlon» sporting goods hypermarket, «Detsky mir», «Cinema Park», «Babylon» entertainment center
Rio na Leningradskom	32 000 / 21 000	Tashir	DIY-hypermarket «Nash dom»
Zolotoi Vavilon Rostokino	241 000 / 170 000	Patero Development	Food hypermarket O'Kei, MediaMarkt, Stockmann, cinema «Lyuksor»
Gorod Lefortovo	237 000 / 110 000	GK TEN	Hypermarket Auchan, DIY-hypermarket Leroy Merlin, «Decathlon» sporting goods hypermarket, «M.Video»

Source: Blackwood research

Professional retail centers opened in 2009, Moscow



Source: Blackwood research

Demand

Throughout 2009, demand for retail space remained unstable. Starting from the end of 2008 and during the first six months of 2009, the activity of retail operators was at a low level which resulted in decreasing demand for space in shopping malls and in the street retail segment. However, the retail activity increased in autumn: the number of transactions grew up and as a result, the rental rates stopped falling (the rental rates even rose in some properties and shopping galleries) and vacancy rates declined.

Still, 2009 was a challenging year for many retail operators: some announced a decline in turnover, an overwhelming majority curtailed development efforts (first of all, in regional cities). Several operators were forced to leave the market and declare bankruptcy – mainly, small chains which had had a weaker position prior to the crisis. On the other hand, major retailers strengthened their market position by active expansion which included, among other things, acquisition of less successful and bankrupt market players.

We should name the international brands which entered the Russian market in 2009. Mostly, these are clothes stores launched in the Metropolis Mall in the Leningradskoe highway: H&M, Gap, New Look, Bebe, Ipekyol, River Island, IKKS, Coast. Against all expectations, the Golden Babylon Rostokino Mall opened in autumn had only one new brand, Lindex, a Swedish fashion chain, part of Stockmann Group.

Speaking about other segments, we should mention the launching of the first Kika furniture and home appliances hypermarket which took place in April in the Novorizhskoe highway. The second hypermarket was opened in November in Samara. The retailer operates in the medium price sector. This niche was previously occupied by IKEA stores. The gross area of the hypermarkets is approx 10,000 – 15,000 sq. m.

The launching of Carrefour, the world's second-biggest retailer deserves a special mention. The first hypermarket was opened in June in Filion retail center in Bagrationovsky proezd, later another hypermarket was opened in Krasnodar. However, in October the retailer announces its plans to abandon the Russian market. The company plans to sell its stores in Russia given the absence of sufficient growth prospects in the short-and medium-term that would have let it attain leadership. In late October, the company said it contemplated maintaining its presence in the market by selling franchises to other retailers.

British toy chain Hamleys never opened its first store and Burger King, the world’s second-largest hamburger chain, failed to launch its first Russian restaurant in 2009 (it was finally opened in the Metropolis Mall on January 21, 2010).

We can name the following new projects of Russian retailers and developers. X5 Retail Group launched SMARTMEDIA as a unified brand for music, movies and electronics offerings. Tashir Group of Companies launched Kids Garden, a chain of stores for children. FD Lab launched its own chain of goods for children under the Skazka brand.

Rental rates

Seeing stabilization of rental rates both in retail centers and in the street retail segment, more optimistic market players said the market had hit the bottom and that the retail sector would soon grow up.

However, we should remember that the rental rates are defined by the supply and demand ratio. Today supply is growing fast in Moscow and regional cities as numerous projects which were announced during the market boom and were close to completion prior to the crisis are coming into the market. Still, facing a drop in turnover retailers are forced to postpone expansion plans as sales dynamics depend upon per capita income and people’s expectations regarding the economic situation in the country. As a result, we can hardly expect the rental rates to grow fast. Today market players don’t announce any new projects which will lead to new deficit of supply and, consequently, the rental rates will rise.

Street retail segment

The street retail market segment wasn't active in H1 2009 as sale and lease transactions were few and far between, the rental rates kept falling and the vacancy rates kept growing. As a result, the rental rates in the main retail corridors of Moscow decreased 40-60% versus the period prior to the crisis and the vacancy rates reached 10-15%. The market didn't see any transactions in summer and the market indexes didn't undergo any changes.

However, in the end of Q3 2009, the segment showed some signs of recovery: the number of transactions increased, the vacancy rates declined and the rental rates stopped falling. Possibly, one of the reasons is that landlords strived to get more money for their space seeing the renewal of business activity after the traditional dead season. Besides, many market players said that the market had already hit the bottom, therefore retail space could be leased at higher rates. This trend remained in force till the end of the year. Besides, the supply will be limited in a short-term and long-term perspective (especially, high-quality space in the popular shopping corridors with high pedestrian flows) which is an additional factor which helps the sector recover.

We shouldn't forget that in order to ensure rapid growth, the national economy should fully recover from the recession. Consumption growth will result in an increasing turnover of retailers.

Rental rates and vacancy rate in Moscow retail corridors, as of december 2009

Retail corridor	Vacancy rate, %	Rent , $ per sq. m.
Tverskaya	2,0%	1 900 - 5 200
1-ya Tverskaya-Yamskaya	2,5%	1 000 - 3 200
Arbat	н/д	1 450 - 2 500
Noviy Arbat	10%	1 500 - 2 300
Pyatnitskaya	5,9%	1 300 - 1 650
Petrovka	1%	2 950 - 4 500
Sadovoe kol'tso	4,5%	1 100 - 2 800
Kutuzovskii prospekt	н/д	1 100 - 2 250

Source: Blackwood research

Investment deals

In 2009, the retail market lost transparency and major institutional investors left Russia. Since nobody seems to understand when the Russian economy and the global economy in general will recover from the economic collapse, buyers and sellers of real estate adopt a wait-and-see approach: the first expect prices to fall further and the latter are reluctant to sell their assets at distressed prices.

Banks acquired numerous assets which served as collaterals on credits in the course of the debt restructuring process and have become new key market players.

Major deals on retail real estate market, 2009

Subject of transaction	Buyer	Seller
50% of «Voentorg» multifunctional center	«NAFTA Co»	«AST» group of companies
75% (minus 1 share) of «Laventa» company stocks (manages «Santa House» store chain)	«Hammar Invest AB» investment fund	«Laverna» group of companies
20 stores of «Pur Pur» store chain, brand rights	F.D. Lab (clothes, shoes and accessories distributor)	«KIT Finans»
50% (plus 1 share) of Fasipero company stocks (owns «Eldorado assets»)*	«PPF» financial group	Fasipero
11 restaurants «Tin'koff», Brand «Chastnye pivovarni Tin'koff»	Fund Mint Capital	Businessman O. Tin'kov
35,4% assets of «Lenta»	TPG Capital fund (USA), «VTB Capital»	Businessman O. Zherebtsov
50% + 2 shares ZAO «Mosmart» and ZAO «Gipertsentr»	«Sberbank Capital»	Sarnatus Trading
25% of «Gimenei» retail centre	«Alfa Bank»	Peresvet Group

Source: Blackwood research and open sources

Forecast

Ten professional shopping malls with a gross area of approx 1,5 mln. sq. m. (leasable area – approx 0,6 mln. sq. m.) are expected to come into the Moscow market in 2010. Mostly, these properties were announced during the retail market boom. All financial issues were settled prior to the crisis.

We also believe that as long as retailers are facing a drop in sales and as long as borrowed funds remain inaccessible, developers of retail centers under construction will find it difficult to lease space. It will be especially difficult for projects with unfavorable location characteristics and for projects whose concept has some shortcomings. Besides, leasing space in regional cities will remain a challenging task.

The vacancy rates in the operating retail centers will fluctuate within a range of 5-10% in successful shopping malls and within a range of 10-15% in least successful ones. The vacancy rates in the main trade streets are unlikely to undergo any serious changes but will continue to fall.

Speaking about the rental rates, we expect them to stop declining in 2010 provided the domestic and global economies don't collapse. The rental rates in the most popular shopping malls will experience a stable growth as high quality retail space slowly increases.

Since no new projects were announced in the retail market in 2009, we believe the market will face new deficit of high quality supply as soon as the crisis is over which will result in new growth of rental rates. However, it can only be expected in one year and a half – two years.

Supply

In 2009, the hotel market of Moscow experienced recession as commissioning of most new hotels was postponed and hotel business activity declined.

In 2009, 8 hotels (approx 1,000 rooms) and suites in the Federation Tower operated by the Global Hyatt Corporation were commissioned. New supply consists mainly of three and four-star hotels (90% of the aggregate supply). The high-price segment is represented only by the suites operated by Hyatt.

Apart from the Grand Hyatt Residences&SPA, two more hotels operated by international companies were launched in Moscow: the Holiday Inn Moscow Simonovsky (Intercontinental Hotel Group) and the Ibis Moscow Paveletskaya (Accor). Besides, the first capsule 66-room hotel called Air Express was opened at Sheremetyevo airport (Khimki, Moscow Region).

All in all, we should say that 5,000 high-quality rooms were added to the Moscow hotel market in 2005-2009. As of the end of 2009, international companies operated approx 6 850 rooms.

Commissioning of numerous hotels which were supposed to open in 2009 was rescheduled for 2010. Therefore, we expect several major hotels operated by international companies to come into the market in 2010. All these announced projects fall into the high-cost category.

Hotels commissioned in 2009

Name	Address	Class	Room stock
Grand Hyatt Residences & SPA	Krasnopresnenskaya emb., Moscow City, Federation Tower	5*	25
«Volynskoe» congress-park hotel	Starovolynskaya str., h. 9	4*	38
Holiday Inn Simonovsky	Simonovsky val, h. 4	4*	217
Kadashevskaya	Kadashevskaya emb., 26	4*	35
Akvamarin	Ozerkovskaya emb., 26, b. 1	4*	150
Maksima Panorama	Masterkova str. 4	3*	123
Ibis Moscow Paveletskaya Hotel	Schipok str., h. 22	3*	147
Akvarium hotel	MKAD, 66 km	3*	225
Hotel	Nizhegorodsky district	n/d	35
Vozdushny express (capsule hotel)	Sheremetevo airport	n/d	66

Source: Blackwood research

Projects scheduled for commissioning in 2010

Name	Address	Class	Room stock
Radisson Royal Hotel	Former «Ukraina»hotel	5*	507
Lotte Hotel	Novinsky bul, h. 8, b. 2	5*	304
Intercontinental Moscow Tverskaya	Tverskaya str., h. 22	5*	205
Courtyard Marriott Moscow Paveletskaya	Kozhevnicheskaya str., h. 8/4	4*	170
Mercure	Smolenskaya sqr, h. 6	4*	103
Renaissance Moscow Monarch center	Leningradsky prosp., h. 31, b. 2, 3	4*	300
Azimut hotel	Business district Danilovskaya manufactory	3*	144

Source: Blackwood research

Demand

Over the last years, the Moscow market experienced a sharp deficit of quality supply, therefore occupancy rates remained at a high level and accomodation costs grew constantly. However, under the impact of the global financial crisis, the situation changed sharply and demand plummeted across all the segments.

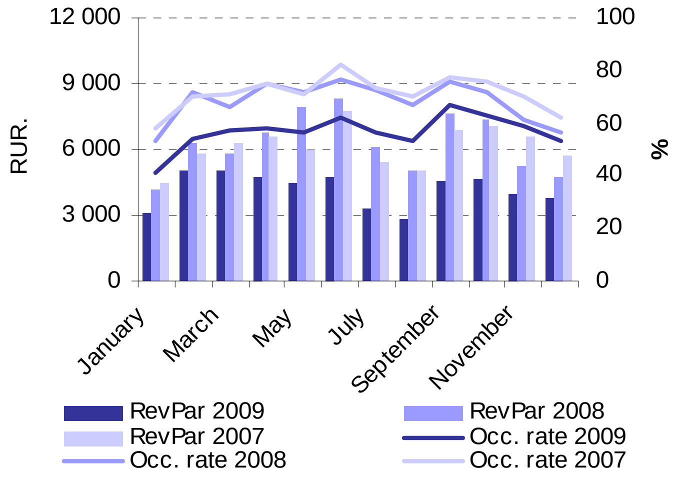
In January-December 2009, the occupancy rates in Moscow hotels fell 28% on average versus the corresponding period of 2008 reaching 50%. The occupancy rates in low-cost and mid-cost hotels dropped dramatically (33% and 30% respectively). The occupancy rates in the high-cost hotels declined 14% versus 2007 and 11% versus 2008.

Partially, the occupancy rates decline was caused by decreasing tourist flows. According to preliminary estimates, the tourism flow fell 10%. Since the occupancy rates decline was bigger than the decline in the tourism flow, we may decline that tourists a) reduced periods of stay and b) chose alternative means of accomodation during their stay in Moscow.

Since the business tourism segment is most developed in Moscow, the occupancy rates of the city hotels traditionally depend upon business activity: in summer and during the New Year holidays the occupancy rates in the Moscow hotels decline and reach their maximum in September-October. As the business activity decreased under the impact of the crisis, this trend became even more pronounced. The high-cost hotels most depend upon seasonal changes: the difference between the occupancy rates on business days and weekends reached 40%.

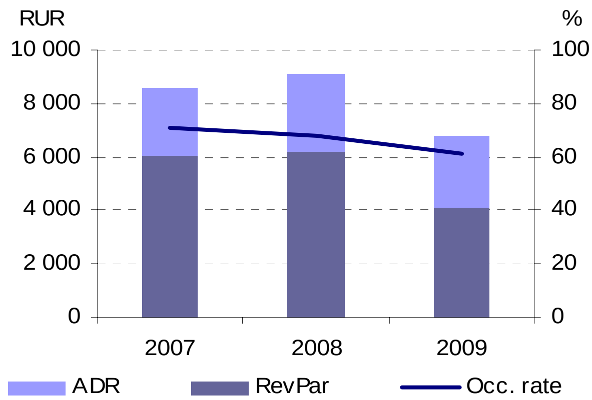
Over the last five years, Moscow led the way in terms of growth of RevPar. Starting from 2000, it increased more than 2,5 times reaching 6,300 rubles in the end of 2008. However, as the crisis hit Russia its growth decelerated and then RevPar began to fall. In 2009, this index dropped by more than 40% as the hotel occupancy rates and sale prices simultaneously went down.

RevPar and Occupancy rate in Moscow upscale hotels



Source: Blackwood research

ADR, RevPar and Occupancy rate in Moscow upscale hotels



Source: Blackwood research

Accomodation costs

In 2009, the most efficient way to attract clients was to reduce room prices. Hotel operators, such as Marriott, Four Seasons and others, offered travel deals, additional services, incentive bonuses, free overnight stays.

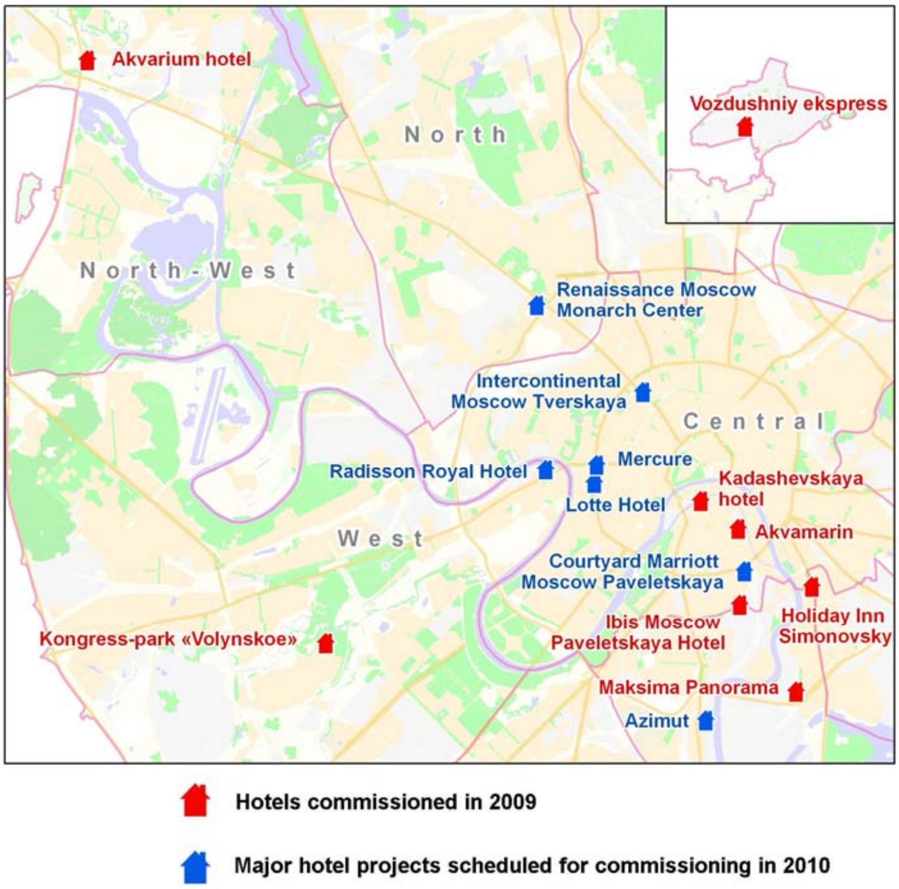
The average ADR amounted to 4,050 rubles, 15% less than in 2008. ADR in the high-cost segment saw the biggest decline, 26%, reaching 6750 rubles. The decline in ADR in the mid-cost segment was 14,5% (3,180 rubles). ADR in the low-cost segment rose 14% amounting to 1,780 rubles.

Announced projects

Among major new projects announced in 2009 are:

- InterContinental Hotel Group is planning to build the biggest Holiday Inn hotel in the territory of Crocus City. It will offer 1.000 guest rooms. It's planned to commence construction in 2011 and launch the building in 2014;
- Large-scale Serp i Molot factory territory development project which includes construction of a four and two-star hotel as well as commercial and residential properties with a gross area of more than 4 mln. sq. m.
- Hotel and business complex measuring over 50,000 sq. m. will be built at 31 Sadovnicheskaya Street;
- Shangri-La Hotels and Resorts signed an agreement to operate a five-star hotel in Moscow. The 400-room hotel which will greet its first guests in 2012 will be located on the upper floors of the Huaming Park MFC;
- The 237-room Mandarin Hotel in Tverskaya Street will be opened in 2011;
- Lotte Group said it will complete the construction of the MFC with a gross area of 60,000 sq. m. in Profsoyuznaya Street in 2012;
- A deluxe 110-room hotel will be opened at the address where the building housing the editorial office of the Moscow News newspaper was located;
- A complex spanning over 50 thous. sq. m. will be developed in the central part of the Moscow City IBC. The 400-room Novotel Hotel of Accor chain will occupy the biggest part of the complex;
- A new building and an apart-hotel will be built within the framework of the new Izmaylovo Hotel development project. As a result, the hotel will consist of 5.050 rooms (#1 in the map);
- A hotel including 300 rooms and 60 suites will be developed above Ulitsa 1905 goda metro station as part of the multifunctional hotel and business complex construction project;
- MCG Company said it will reconstruct the Budapest Hotel and convert it into a modern deluxe hotel property;
- The town-planning council made a decision to build a four-star hotel above Mayakovskaya metro station. The hotel is expected to include 300 rooms.

Hotels commissioned in 2009 and major hotel projects scheduled for commissioning in 2010



Source: Blackwood research

Trends and forecast

Over the last years, the Moscow hotel market saw high demand for accomodation means and sharp deficit of quality supply. However, in 2008, under the impact of the global financial crisis, the situation changed dramatically and hotel business activity declined.

As the tourism flow decreased and competition flourished operating companies offered various incentive programs to encourage demand.

Many companies aimed at cutting expenses thus compensating a decline in turnover. Many chains promoted their services by means of internet chains. Thus, according to Expedia Inc, the number of hotels connected to its booking sites increased more than 80% in 2009.

Since the beginning of the crisis, project implementation periods became longer and most projects expected to come into the market in 2008-2009 were never commissioned and several landmark projects were cancelled.

Many companies signed operation agreements several months before the project was expected to be delivered, which was another market reaction to the ongoing crisis.

In a short-term perspective, the average occupancy rates of the Moscow hotels will remain at 55-60%. The occupancy rates in the high-cost hotel will remain above the average market level but as new supply is commissioned they will see some adjustment depending upon whether the anticipated plans of delivery of new hotels are fulfilled.

We don’t expect any further decline in average sale prices. However, the prices are likely to return to the level reached prior to the crisis only by the end of 2011 – beginning of 2012.

Most hotels of the mid-cost category will be built outside of the Third Transport Ring. Thus the biggest Holiday Inn Hotel will be launched in the territory of Crocus City. Its construction will begin in 2011.

In a long-term perspective, the international operators will strive to gain a foothold in the Moscow market and the Russian market in general as its potential remains high even though many of them had to reconsider their plans due to the crisis.