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COMMERCIAL REAL ESTATE MARKET OVERVIEW Q1 2011



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Summary

Approximately 250 thous. sq. m. of high-quality areas entered the office real estate market for Q1 2011, 40% of them were "A" class properties, 60% - "B" class. Therefore, the aggregate supply volume in the office real estate market amounted to about 11 mln. sq. m.

The recovery of demand for rent and purchase of high-quality office premises is going on in high paces. By the results of Q1 2011 the share of vacant premises amounted to approx 13-15% in "A" class and 15-17% in "B" class.

In general, the beginning of the year was rather positive for the office real estate market, the market continues to display rather stable indices, at the same time all the post-crisis trends remain relevant. The development market is recovering: for Q1 2011 the construction of several promising projects, as well as the resumption of the implementation of a number of large projects was announced.

The trend of the recovery of demand for the high-quality office real estate remains relevant: during Q1 2011 both tenants and buyers of office premises remained rather active, a lot of deals were concluded and announced, including rather large ones.

During Q1 2011 the tenants of high-quality office premises stayed very active, which made it possible to state the further growth of rental rate, which, by the results of Q1 2011 is estimated at the level of 5-10%.

Nevertheless, despite the existing positive dynamics, negative post-crisis trends are still tangible.

During Q1 2011 a technical opening of one of the professional retail centers – "Afimall City" in the structure of "Moscow-City" MIBC took place. As the majority of properties commissioned in 2009-2010, "Afimall City" was opened with partially operating retail gallery. With the opening of "Afimall Russia" the total supply volume increased up to 5.98 mln. sq.m., the leasable area of which amounted to 3.03 mln. sq.m.

In Q1 2011, retail operators' high activity, which contributed to the growth of the deals quality and the reduction of the vacant premises level both in the professional retail segment and the street retail segment, was observed.

Retail operators' high activity is conditioned by the growth of buyers' activity. Thus, according to Federal service of state statistics, the turnover of retail trade in Russia increased 4.7% YoY in Q1 2011. The announcement of German chain of perfumer's shops Douglas Rivoli about the exit from the Russian market became another important event of the retail real estate market. The stabilization of rental rates at the level reached at the end of 2010 could be observed in the professional retail real estate market during Q1 2011. Minor fluctuations towards raise were observed for the most sought-after retail centers, as well as for the prestigious retail corridors.

During Q1 2011 new supply in the hotel market of Moscow increased by 149 rooms at the expense of the opening of the club hotel Crowne Plaza Moscow World Trade Center on the territory of "Moscow-City" MIBC. As the majority of opened in the past years hotels, the new hotel Crowne Plaza is positioned in the upper segment of the market. With the account of its location and in case of the competent sales politics and the promotion in the market, the hotel may expect the stable high occupancy rate.

During Q1 2011 two hotels under international hotel operators' management were opened in regional cities: Courtyard by Marriott in Kazan (4*, 150 rooms) and Ibis in Nizhny Novgorod (3*, 220 rooms).

During the last 2-3 years the competition among hotels under international operators' management became very high in some largest regional cities due to the active policy of development of the market main players.

In future, the shift of international operators' interest towards smaller cities may be expected as the hotel markets of the largest regional cities approach the saturation: there are already the announcements about the future projects in such centers of business and tourist demand, as Kaluga, Yaroslavl, Voronezh, etc.

OFFICE REAL ESTATE

Q1 2011

Supply

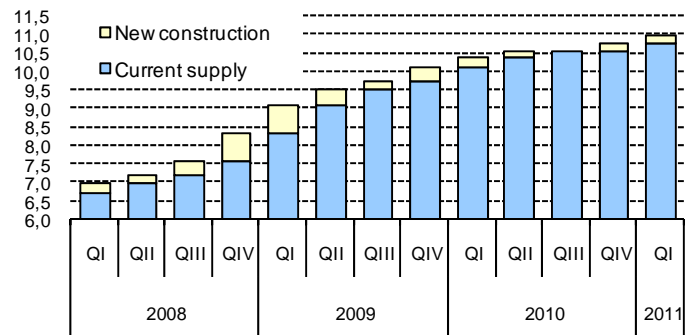
Approximately 250 thous. sq. m. of high-quality areas entered the office real estate market for Q1 2011, 40% of them were “A” class properties, 60% - “B” class. Therefore, the aggregate supply volume in the office real estate market amounted to about 11 mln. sq. m. At the same time, the trend of the slowdown of new properties delivery volumes, characteristic of the previous year, remains relevant in 2011 as well.

The recovery of demand for rent and purchase of high-quality office premises is going on in rather active paces, and, despite the fact that the demand is still greatly differentiated by both the geography and the quality of properties, the share of vacant supply is gradually decreasing: by the results of Q1 2011 the share of vacant premises in “A” class amounts to approx 13-15%, “B” class – 15-17%. The office market within the Central business area is already close to complete recovery, the demand is gradually growing for the more distant from the center districts as well, and the growth rates will gain force due to the rather tough restriction of new construction within the TTR.

In general, the beginning of the year turned out to be rather positive for the office real estate market, the market continues to display rather stable indices, at the same time all the post-crisis trends remain relevant. The development market is gradually recovering: the construction of several promising projects, as well as the resumption of the implementation of a number of large projects was announced:

- Shalva Chigirinsky’s ST Tower Company is going to construct another complex measuring 250 thous. sq. m. (instead of the earlier planned 520 thous. sq. m.) at the place of “Russia” tower as the part of “Moscow-City” MIBC;

Dynamics of supply volumes, mln.sq.m



Source: Blackwood research

- The construction of City Palace MFC, which changed the name for “Evolution” after the exit from “Inteco” project (sold its share to Victor Rashnikov, the owner of Magnitogorsky metallurgical complex), was resumed on the territory of “Moscow-City” and, possibly, will go through conceptual changes as well;
- Midland Development will undertake to complete a famous uncompleted construction project “Tsarev sad” (“Tsar’s garden”) at Sofiyskaya emb., which belonged to Sberbank;
- Systema Gals implemented the reconception of the complex at Leningradsky pr. after Siemens Company had exited the project, and plans to deliver “A” class BC called “Skylight” to the market in 2012.

Some projects announced for for reconception/construction in Q1 2011

Developer/ Investor	Name and class of property	Address	Announced area, sq. m
<i>Unfreezing / Reconception</i>			
STT-development	MFC(“Russia” tower)	Moscow-City, participants 17-18	250 000
MR Group	MFC (MR Group)	5, Golovinskoe highway	166 300 (offices 61 570)
Snegiri development	Evolution (City Palace)	Moscow-City, participants 2,3	169 000
Systema-Gals	SkyLight (Siemens towers “Systema Gals”)	39, Leningradsky pr.	111 000
Midland Development/Sberbank	“Tsar’s Garden”	36, Sofiyskaya — 10, Bolotnaya	80 000
n/a	Parliament center (“Russia” hotel)	Moskvoretskaya emb.	n/a
<i>New construction</i>			
Bosch	Bosch Office	Khimki	57 000
n/a	MFC “Zvezdny”	Korolev	34 000

Source: Blackwood research

Demand

The recovery trend of demand for the high-quality office real estate is still relevant: during Q1 2011 both tenants and buyers of office premises remained rather active, a lot of deals, including rather large ones, were concluded and announced.

As far as the demand structure by incoming requests to Blackwood Company is concerned, by the results of Q1 2011, they were distributed in the following way: 60% of all the requests were requests for rent, and 40% - for the purchase of office premises. It should be mentioned, that the share of requests for the purchase increased considerably for the recent period.

The leader in the demand structure for rent depending on the class of the property is still "B-" class, at the same time its share is gradually declining, and the demand for the more high-quality properties of "B+" and "A" classes is growing.

The largest share in the demand structure for office premises rent by area consists of the blocks measuring up to 200 sq.m. (39%) – this segment is still the most popular.

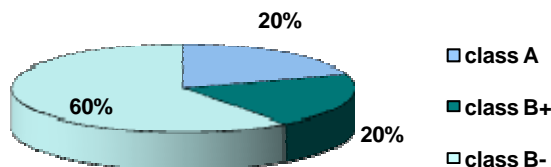
The gradual redistribution of demand towards more high-quality premises is taking place in the sale-purchase segment of high-quality office premises: despite the fact that the leader in the demand for the purchase is still "B-" class, its share in the total structure is gradually declining.

As for the distribution of demand for the purchase of offices depending on the area of premises, its structure stays rather stable, at the same time, the growth of the share of requests for the purchase of the smallest blocks (from 16% to 26%) versus the indices of the end of 2010 may be noted.

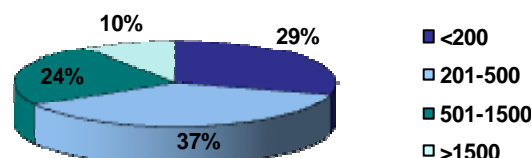
The general trends in demand in the high-quality office real estate market in Q1 2011 were the following:

- demand for rent and purchase of premises stays rather high;
- the average rented area and the terms of the conclusion of lease agreements are gradually increasing;
- demand for the noninvestment purchase of premises is still rather high.

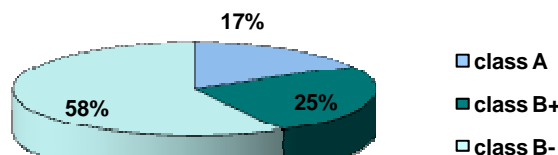
Structure of demand for office premises rent by class



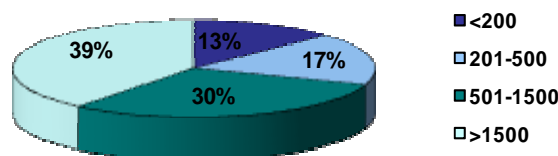
Structure of demand for office premises rent by metric area



Structure of demand for office premises purchase by class



Structure of demand for office premises purchase by metric area



Source: requests to Blackwood in Q1 2011

Rental rates and sale prices

During Q1 2011 the tenants of high-quality office premises remained very active, which made it possible to state the further growth of rental rates, which by the results of Q1 2011 is estimated at the level of 5-10%.

As the result, by the end of Q1 2011 the average weighted rental rates for the office premises depending on class amounted to: 750\$/sq.m. per year in "A" class, 520\$/sq.m. per year in "B+" class, 360\$/sq.m. per year in "B-" class (all the rates are presented exclusive of VAT and OPEX). OPEX for the period under consideration amounted to \$75-\$120 per sq.m. per year for "A" class premises, \$50-\$90 – for "B+" class, \$35-\$60 – for "B-" class.

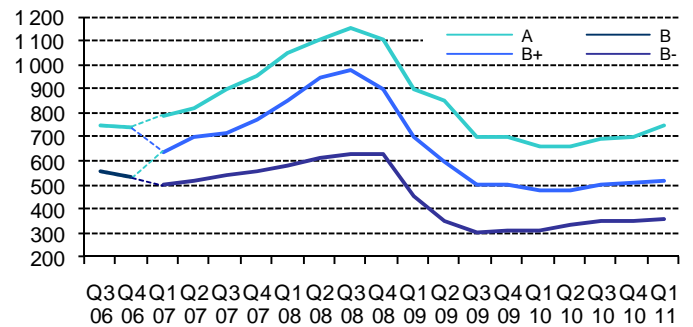
The price situation in the sale-purchase segment of high-quality premises is the following: the price varies from \$5, 000 to \$ 10, 000 per sq.m., for "B+" class - \$3, 500-\$6, 000 per sq.m., for "B-" class premises - \$2, 500-\$4, 000 per sq.m.

Important events and deals of Q3 2010

In Q1 2011, the trend of gradual recovery of investment activity was outlined, the following deals were concluded and announced:

- Sminex company purchase of two industrial sites: OAO "Niivitaminov" in Nauchny proezd (1.2 ha) and OAO "RI Dragmetallov" in Nastavnichesky per. (1ha);
- Rusnarbank co-investors' possible purchase of "Sadko" BC (bld.2, 50A/8, Zemlyanoy val, total area – 12, 180 sq.m.);

Dynamics of office area-weighted average rental rates, \$/



Source: Blackwood research

- One of the largest NPF planned purchase of Marr Plaza business-center (operating business, total area – 34, 000 sq.m.);
- OAO "Rostelekom" planned purchase of a business-center measuring approx 70 thous. sq.m. with the planned budget of \$300-350 mln. for itself;
- VTB bank possible purchase of the "Transport terminal" project (11th site, total area of the project – 228 thous.sq.m., developer – Citer Invest, planned term of delivery - 2015).

Some transactions concluded in Q1 2011

Buyer/ Tenant	Name of property	Leased area	Address
ZAO "Grinatom"	BC (AFI Development)	13 500 sq. m	Paveletskaya emb.
"Russian Development Bank"	BC "Progress"	7 312 sq. m	79, Sadovnicheskaya str.
CTC Media	"Monarch center"	7 000 sq. m	31 A, Leningradsky prosp.
"ProfMedia Business Solutions"	"Ryadi Soldatenkova", "Danilovskaya manufacture 1867"	5 200 sq. m	Bld.1, 9, Varshavskoe highway
LG Electronics	"Setun" BC	3 209 sq. m	Bld.2, 10A, 4 th Setunsky pr.
Align Technology	Loft bureau, "Danilovskaya manufacture"	2 030 sq. m	9, Novodanilovskaya emb.
NVIDIA LTD	"Dvintsev" BC	2 000 sq. m	14, Dvintsev str.
Tesco AG	Mansion	1 300 sq. m	23B, B.Strochensky per.

Source: Blackwood research

Nevertheless, despite the existing positive dynamics, the negative, post-crisis trends are still tangible: thus, it was reported in Q1 2011 that two largest transactions took place:

- "Transneft" company refused from the purchase of "Alfa Arbat center" BC measuring 43, 000 sq.m., belonging to TNK BP. The latter continues negotiations with other interested in the purchase companies;

- The Cyprus Bedhunt, the buyer of "Kosinskaya Plaza" BC, measuring 112 thous. sq.m., intends to return the property to AFI Development, the former owner, as it failed to operate the building for the intended purpose (for trade).

Supply

A technical opening of a professional retail center – “Afimall City” in the structure of “Moscow-City” MIBC took place during Q1 2011 in Moscow. As the majority of properties, commissioned in 2009-2010, “Afimall City” was opened with a partially operating retail gallery. According to the developer’s announcements, the first in Russia store of American chain Banana Republic is planned for opening in REC.

The aggregate supply volume of professional retail centers increased up to 5.98 mln.sq.m., the leasable area amounted to 3.03 mln.sq.m., with the opening of “Afimall Russia”. Therefore, the provision of Moscow population with the high-quality retail centers amounted to 289 sq.m. per 1, 000 residents by the end of Q1 2011.

According to the developers’ announcements, more than 5 large professional retail centers are planned for delivery in 2011: “Gudzon”, “River Mall”, RC in North Chertanovo, RC in the “Moscow” hotel, the 2nd stage of “Rechnoy” REC and a

number of others. The aggregate area of the announced for opening in 2011 professional retail centers exceeds 500,000 sq.m. Therefore, with the account of traditional delays in the opening of new properties, it may be forecasted that the increase of new supply in the professional retail real estate market of Moscow will be much lower than the indices of 2009-2010.

As for the new projects, in Q1 2011, the “Finstroy” developer declared its willingness to construct a REC at the intersection of MKAD and the Altufievskoe highway. The opening is scheduled for the end of 2012. The total area of REC will amount to 77,000 sq.m., the leasable one – 56, 000 sq.m., the anchor tenant will be “O’key” hypermarket. The REC will be located near Auchan hypermarket, Leroy Merlin and Decathlon, which will make it possible to expect a positive synergetic effect and the attraction of additional buyers.

Professional retail centers delivered to the market in Q1 2011

Name	Total area/ Retail area, sq. m	Developer	Main tenants
Afimall City	179 000 / 114 000	AFI Development	“Zeleny Perekrestok” supermarket, “Eldorado” appliance store, “Sportmaster” sports goods store

Source: Blackwood research

Demand

In Q1 2011, retail operators were very active, contributing to the growth of the number of deals and the decrease of the vacant space level both in the professional retail segment and in the street retail segment.

Retail operators’ high activity was conditioned by the growth of buying activity. Thus, according to the Federal State Statistics Service, the turnover of retail trade in Russia was 4.7% up in Q1 2011 versus the corresponding period of 2010. At the same time, the retail turnover of nonfood goods increased more considerably – by 8.3%. It should be noted that the growth of prices in the nonfood sector was insignificant (1.7%) in Q1 2011, which was indicative of the consumption growth of this group of goods in volume terms. Against the background of considerable increase of the nominal wages (10.1% versus Q1 2010), the consumers’ advanced activity was the result of the deferred demand: the population strives for compensating for the reduced in the crisis period consumption, feeling the growth of incomes following the announcements about the passing of “the crisis bottom”.

In Q1, two international retail operators entered the Moscow market:

- American chain of restaurants Chili’s Grill & Bar;
- Portuguese chain of children’s clothing stores Petit Patapon (the first Russian store of the chain was opened at the end of 2010 in Krasnodar);
- Both retail operators develop in Russia according to the franchising scheme.
- Besides, during Q1 2011, a number of international operators announced their planned entry to the Russian market:
- Chain of premium class boutiques Jimmy Choo;
- Chain of clothing stores Banana Republic.

An important event of the retail real estate market was the announcement of the German chain of perfumeries Douglas Rivoli about its leaving the Russian market. The company de-

Demand

cided to leave Russia despite stable results of its activity (the group ranked the 4th place by the volume of gain after “L’etoile”, “Rive Gauche” and “Ile de Beaute” chains). One of the reasons

of leaving was impossibility to reach the leader’s positions due to the high competition. The analogous factors were mentioned as the reasons for Carrefour chain of hypermarkets leaving the

Rental rates

During Q1 2011, the stabilization of rental rates at the level reached at the end of 2010 may be expected in the professional retail real estate market. Minor fluctuations of rates towards raise were observed for the most sought-after retail centers, as well as for prestigious retail corridors.

against the background of retail operators’ growing activity, as well as with the account of the new supply paces slow down in 2011, the rental rates will be growing gradually.

It is evident of the fact that the prices growth at the end of 2010 was not the result of the single burst of demand on the part of retail operators, but became the beginning of the market recovery process.

It should be noted that in March the Moscow Government adopted legislative acts, which would contribute to the further growth of rental rates in the street retail segment: prohibition of new construction in the central part of the city, as well as the decision about the reduction of retail function to the minimal indices in the projects at Tverskaya Zastava square as well as at the Paveletsky station square.

In 2011, the recovery of both the professional retail segment and the street retail segment will most probably continue:

The level of vacant areas and rental rates of supply in retail corridors of Moscow as of the end of Q1 2011 and in comparison with Q1 2010.

Retail corridor	Share of vacant areas, %	Rental rate, \$ per sq. m.	Rental rate, \$ per sq. m. as of the end of Q3 2009
Tverskaya	1,5	2 300 – 9 250	3 450 – 4 850
1 st Tverskaya-Yamskaya	2,3	2 700 – 4 500	950 – 1 200
Arbat	2,1	1 900 – 3 950	1 300 – 2 240
Novy Arbat	8,9	500 – 2 900	800 – 2 130
Pyatnitskaya	5,0	1 000 – 3 500	1 250 – 2 100
Petrovka	1,3	2 000 – 2 900	2 250 – 2 900
Garden Ring	3,9	1 100 – 2 500	850 – 2 350
Kutuzovsky prospect	3,4	800 – 2 800	1 000 – 2 250

Source: Blackwood research

Forecast

In 2011, the slowdown of new supply increase paces is expected: the projects, which were at the stage of maximum construction readiness before the crisis began, have already entered the market; the remaining projects are being constructed in much slower paces.

Increased buyers’ activity will contribute to the activation of retail operators’ development policy. Advanced demand on retail areas will cause the gradual growth of rental rates and the decrease of vacant areas to the minimal indices.

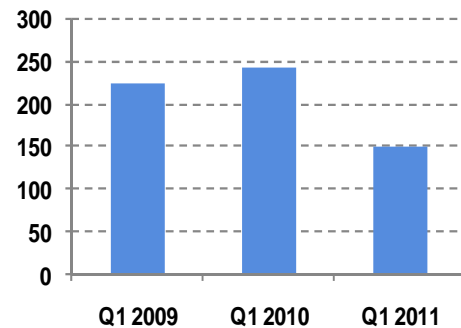
A positive trend of Q1 2011 was the appearance of new projects in Moscow Region, which was indicative of the improvement of the situation in the financial markets and of the growth of assessment of the market prospects by its main participants.

Supply

During Q1 2011, new supply in the hotel market of Moscow increased by 149 rooms at the expense of the club hotel Crowne Plaza Moscow World Trade Center opening on the territory of “Moscow-City” MIBC. As the majority of opened in the recent years hotels, the new hotel Crowne Plaza is positioned in the upper segment of the market. With account of its location and upon the condition of the competent policy of sales and promotion in the market, the hotel may count on the stably high occupancy rate.

The slack in the commercial real estate markets is traditionally observed in Q1. Thus, for the corresponding period of 2010, 2 hotels with the aggregate hotel room capacity of 243 rooms were opened. In Q1 2009, the situation in the hotel real estate market was similar - only one hotel was opened (see the Diagram).

Dynamics of Increase of new room stock supply, Q12009-Q12011, Moscow



Source: Blackwood research

Increase of hotel rooms supply, Q1 2011, Moscow

Name	Address	Class	Number of rooms
Crowne Plaza Moscow World Trade Centre	12, Krasnopresnenskaya nab.	5*	149
TOTAL			149

International operators' activity

During Q1 2011, two hotels under international hotel operators' management were opened in regional cities: Courtyard by Marriott in Kazan (4*, 150 rooms) and Ibis in Nizhny Novgorod (3*, 220 rooms).

During the last 2-3 years, the competition among the hotels under international operators' management in some largest regional cities became very high due to the active policy of the market main players' development. Thus, the hotels of international brands (Park Inn and Ibis) had already been present in Kazan by the moment of the Courtyard by Marriott delivery to the market. The competition on the part of modern independent

hotels should also be taken into consideration (“Korston”, “Mirazh”, “Shalyapin Palace”, etc. in Kazan). High competition will undermine the hotels measures of efficiency and, consequently, reduce the attraction of such markets for developers and hotel operators.

In future, as the hotel markets of the largest regional cities are approaching saturation, the international operators' shift of interest towards smaller cities may be expected: the announcements about the future projects in such centers of business and tourist demand as Kaluga, Yaroslavl, Voronezh and other cities arise already today.

New projects of hotels under international operators' management announced in Q1 2011

Name	City	Class	Number of rooms	Delivery to the market
Hilton Garden Inn Moscow New Riga	Moscow	3-4*	162	2012
Hampton by Hilton Moscow Strogino	Moscow	3-4*	214	2014
Hampton by Hilton	Voronezh	3-4*	140	2013
Mercure Rosa Khutor	Sochi	4-5*	152	2012
Hyatt Place	Yaroslavl	4*	130	2012
TOTAL			798	

Trends and forecasts

The recovery of the market main players' activity both in Moscow Region and in regional cities, which was expressed in the appearance of considerable number of new projects versus the crisis period, could be singled out as the most important trends of Q1 2011.

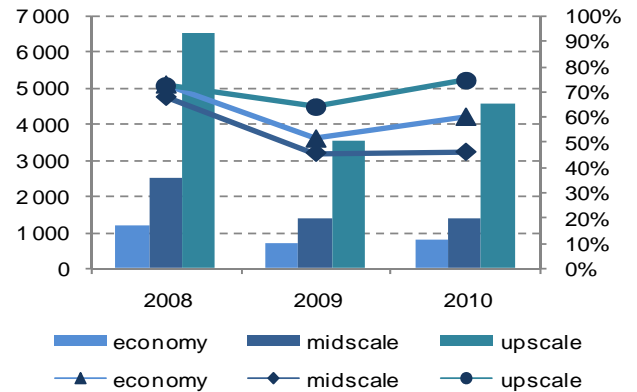
However, considerable growth of supply, which causes the decrease of occupancy rate and sale prices, is not to be expected in Moscow in the nearest years: the delivery terms of many projects will in most likelihood be shifted.

Cost of accommodation

In Q3 2010 the index of average daily room rate (ADR) stabilized for the lower and middle segments and displayed growth for the upper segment hotels. With account of occupancy index dynamics, the Revenue per available room (RevPAR) grew for the upper and lower segments by 28% and 15% correspondingly versus the indices of Q3 2009.

Situation in the middle segment of the hotel market develops less successfully: the outflow of business tourists takes place (towards more expensive hotels), whereas increase of tourists flow does not take place. It is most probably that recovery of this part of demand for accommodation services will take place in lower paces than business demand that is why quick return to the pre-crisis indices of activity is not to be expected even with account of remaining deficit of high-quality supply in the middle price segment of the hotel market of Moscow.

Dynamics of revenue per room and occupancy rate, Q3 2008 – Q3 2010, Moscow



Source: STR Global, GAO «Moskva», Blackwood research

Activity of international hotel operators

During Q3 2010 activity of international hotel operators was concentrated in regional cities. Thus, the opening of hotels under Park Inn brand took place in St.-Petersburg (270 rooms) and in Veliky Novgorod (225 rooms), as well as under Radisson brand in Kaliningrad (178 rooms). Therefore, increasing its presence by 448 rooms, Rezidor Hotel Group reserves the first place in the Russian market by the number of rooms under management with the index of more than 5,700 rooms.

As far as new projects are concerned, “KESKO” company and Accor international operator joint project on the construction of five hotels in such cities as Ufa (2 hotels), St.-Petersburg, Krasnodar and Novorossiysk (by 1 hotel) was announced in Q3 2010.

Russian companies also announced new chain hotel projects in Q3 2010.

Trends and forecast

The main positive result of Q1-3 2010 was the recovery of business demand for accommodation services in Moscow, which was expressed in the growth of occupancy indices and revenue per room for hotels of the upper segment.

However, the recovery of the hotel market on the whole will take place in lower paces in view of the fact that insufficient number of high-quality hotels of the middle and economy classes,

Thus, OAO “Hotel company” plans to develop the chain of economy-class hotels under “VashHotel” brand.

A single system of management and reservation is planned to be introduced in all the properties of the chain, however, a large-scale reconstruction of properties was not announced.

Another large-scale project announced by “Abrau Durso” champagne house and Cronwell Hotels & Resorts hotel operator was the project on foundation of a chain of boutique-hotels with wine spa-centers. The first project will be opened in Abrau Durso by the end of 2010, later, hotels of the chain will appear in Tulsy and Moscow regions. Taking into account the absence of supply of such services of accommodation in Russia, the project may reckon on popularity among potential clients upon condition of proper implementation of the concept, adequate price positioning and aggressive marketing politics.

high price of accommodation and, in case of international tourists, difficulty in procurement of visas, impede the tourists’ demand recovery.

International hotel operators are still very interested in Russian regional cities, where hotels continue to be opened (predominantly in “4* business” segment) and new projects are announced, including chain projects on the base of development and managing companies cooperation.