

The total volume of office completions in Q1 2021 amounted to **309.5 thousand sq m**

Q1 2021 vacancy rate reached **12,0%** in Class A offices and **6,0%** in Class B offices



OFFICE MARKET REPORT. MOSCOW

Q1 2021





Maria Zimina

Director Office Department
Knight Frank

«Despite the pessimistic expectations of market players regarding the results of 2020, a gradual recovery in construction activity and demand is now planned. The result of Q1 2021 completion exceeded the total result not only of the crisis year of 2020, but also of 2018, which was generally stable for the market. The wave of renegotiation and optimization of tenants' spaces actually stopped at the end of last year, which resulted in the predominance of such transactions in the overall structure of demand – the share was about 65-70%. In 2021, we expect an increase in the volume of new transactions, however, given the tendency to reduce the need for space, the absorption of offices may be at the minimum level of last year. Moreover, tenants are still offered the space that entered the sublease market last year, which further affects the low rates of absorption of space.»

Key conclusions:

- ♦ The total volume of office completions in Q1 2021 amounted to 309.5 thousand sq m, 38% more than the total figure of 2020.
- ♦ Q1 2021 vacancy rate reached 12.0% in Class A offices and 6.0 % in Class B offices.
- ♦ Asked rental rates for Q1 2021 amounted to 25,911 rubles/sq m/year in Class A and 16,998 rubles/sq m/year in Class B.

Key indicators. Dynamics*

	2020	Q1 2021
Total stock, '000 sq m	16,998	17,307
Class A	4,594	4,802
Class B	12,404	12,505
New supply, '000 sq m	224	309.5
Class A	129.7	207.7
Class B	94.7	101.8
Vacancy rate, %		
Class A	11.7	12.0
Class B	6.1	6.0
Average weighted asking rental rate*, RUB/sq m/year**		
Class A	25,391	25,911
Class B	16,854	16,998
OPEX rate range*, RUB/sq m/year		
Class A	7,100	7,100
Class B	4,800	4,800

* Compared to Q4 2020

** Excluding operating expenses and VAT (20%)

Source: Knight Frank Research, 2021

Class A and B new supply dynamics

■ Class A ■ Class B

'000 sq m



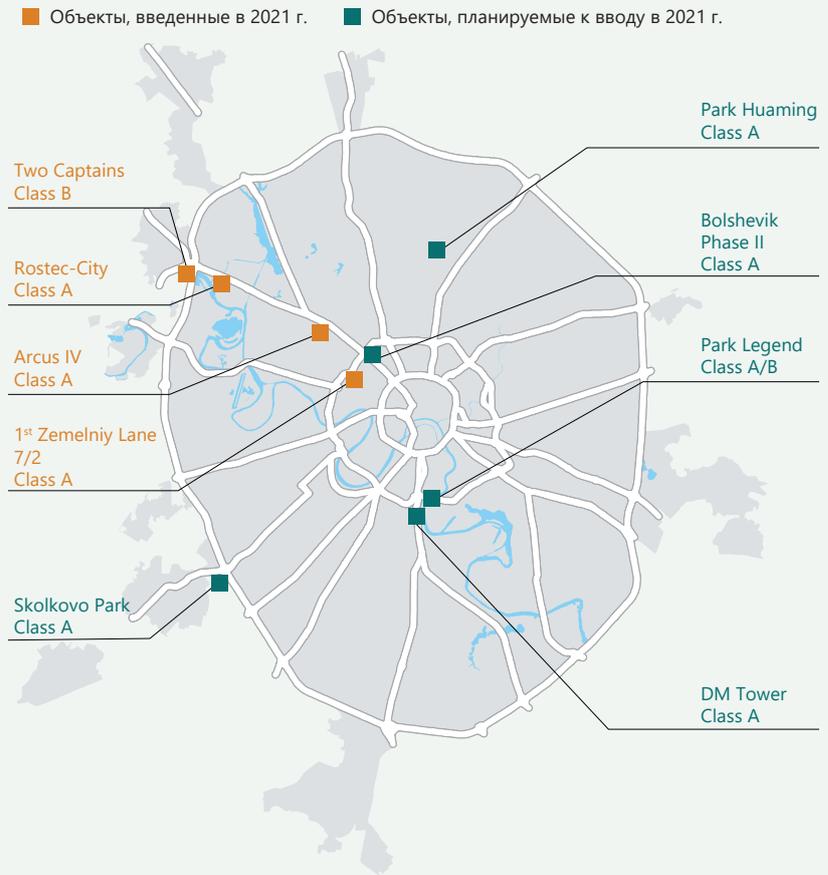
Source: Knight Frank Research, 2021

Supply

At the end of Q1 2020 the total office space in the Moscow market amounted to 17.3 million sq m, including 4.81 million sq m of Class A and 12.49 million sq m of Class B offices.

Following the market uncertainty and the reduced developers' activity resulting in the total completion of office space in 2020 amounting to only 224.4 thousand sq m, over 309,000 sq m completed at once in the first three months, more than in the entire years 2018 and 2020. The construction of one of the largest Moscow office projects, Rostec-City with the leasable area of 173.6 thousand sq m, has been completed. In addition, such large facilities as "Two Captains" with the leasable area of 79.8 thousand sq m and Arkus IV (18,000 sq m) have been officially commissioned. Despite the large areas of new facilities, there was no strong growth in the vacancy rate: "Two Captains" Business Center did not enter the speculative market, as it was built for the needs of government structures that will have their offices there, and Rostec's (State Corporation for Assistance to Development, Production and Export of Advanced Technology Industrial Product Rostec) subsidiaries and partners will gradually move to Rostec-City, which means that the facility areas will enter the market only partially or will not enter it at all.

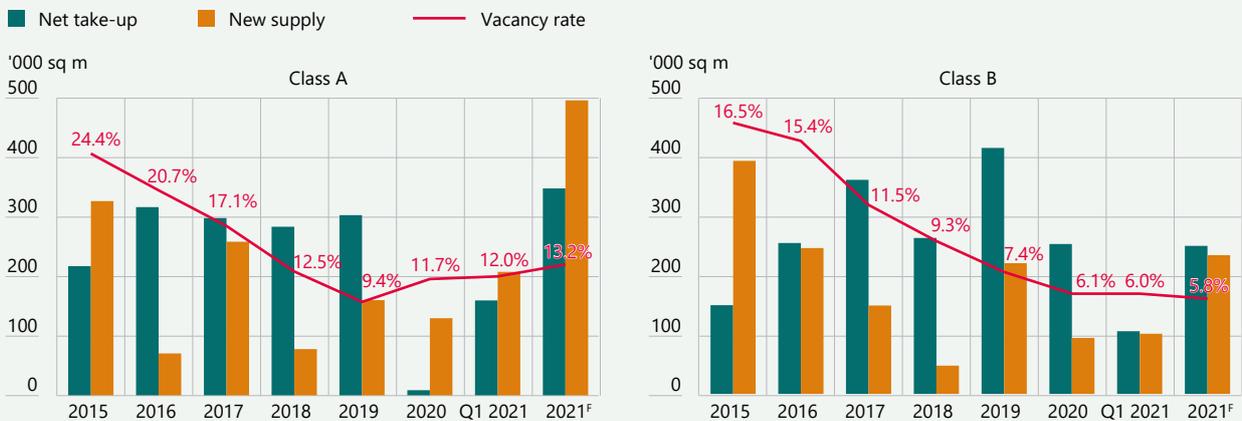
Properties scheduled for delivery throughout 2021*



* Office facilities planning to obtain commissioning certificates in Q1 – Q4 2021. The class of buildings is indicated according to the classification of the Moscow Research Forum 2013.

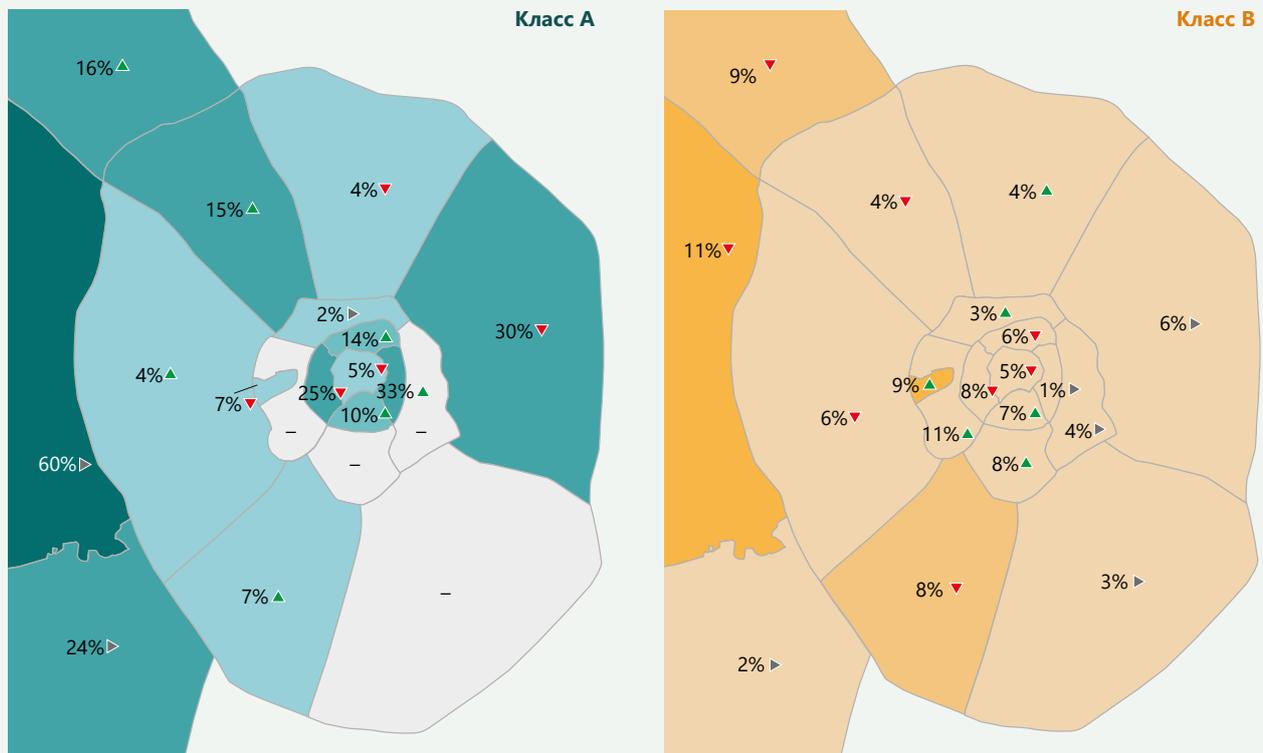
Source: Knight Frank Research, 2021

Net absorption, new supply and vacancy rate dynamics



Source: Knight Frank Research, 2021

Moscow submarket data. Vacancy rate



Source: Knight Frank Research, 2021

The completion of about 420,000 thousand sq m more is expected in 2021. Taking into account the Q1 2021 outcomes, full-year results may exceed 650,000 – 750,000 sq m, which will be the maximum over the past seven years. Nevertheless, developers' behaviour still largely depends on the speed of market recovery: given the sharp and significant decrease in absorption in 2020, specialized developers may put some of their projects on hold while observing the behaviour of office users and the further vector of market development. At the same time, more and more built-to-suit facilities will appear on the market.

The vacancy rate in Class A increased by 0.3 ppt to 12.0% since the start of the year. Currently, about 590,000 sq m of offices remain vacant. The figure of class B decreased by 0.1 ppt to 6.0%, the total volume of vacant space is almost 752,000 sq m. The factor of such dynamics of the Class A figure was the entry of a new Arkus IV (17,975 sq m) project into the market, which was unfilled. Further growth (to

13.1 – 13.3%) is expected by the end of 2021 due to the significant share of Class A in the total projected commissioning in 2021. In Class B the recent years' dynamics continued: a further decrease is expected (to 5.7 – 5.9% by the end of 2021) due to the small volume of offices announced for commissioning, as well as the expected seasonal, more dynamic, business activity.

The growth of sublease in the office market may be called one of the trends in 2020: due to restrictive measures and transfer of a certain part of employees to remote working, a significant number of companies decided to free up part of their space for sublease. The total volume of such space is about 150,000 – 200,000 sq m, some of which are still on the market. The companies that made such a decision include, but not limited to, Deloitte, which office is now located in the White Square business center, or KPMG, which also decided to refuse from some of its offices in the Naberezhnaya Tower and are subleasing some extra

space. There was no significant number of sublease transactions in Q1 2020, but the units remaining on the market are still options for placing companies that previously could not lease premises in premium locations due to the lack of large units.

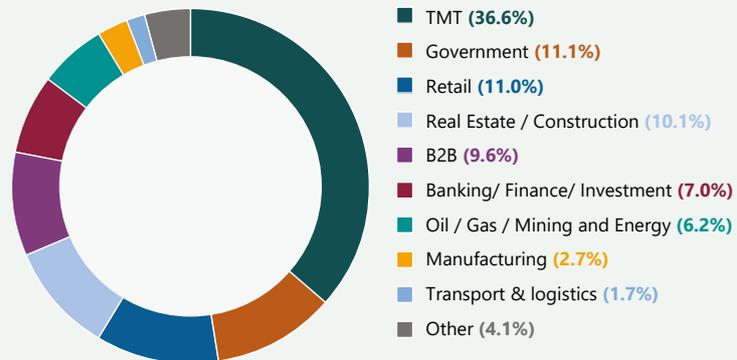
Numerous transactions on the revision of business terms, as well as the complete or partial tenants' refusal from premises, were recorded in late 2020, and the majority of this type of transactions occurred at the end of the year due to the completion of negotiations between tenants who decided to reconfigure their spaces in the first months of restrictive measures due to the pandemic. At the beginning of 2021, there is already much of activity in the conclusion of new lease agreements: the share of such transactions amounted to 62% against 38% of transactions on the optimization of contracts for space and rent.

Demand

Net absorption – a key indicator of demand, demonstrating a certain period's difference between all areas filled and all that have entered the market being vacant – has grown significantly in Q1 2021 due to the commissioning of Rostec-City and Two Captains, which did not enter the speculative market. Taking these facilities into account, the absorption in Q1 amounted to almost 265,000 sq m. However, if these objects are not taken into account in terms of net absorption, the quarterly volume amounted to only 12,000 – 13,000 sq m, being negative in Class A facilities. The trend towards optimization of tenants' space continues: even with an increase in rental activity, companies are striving for smaller of space.

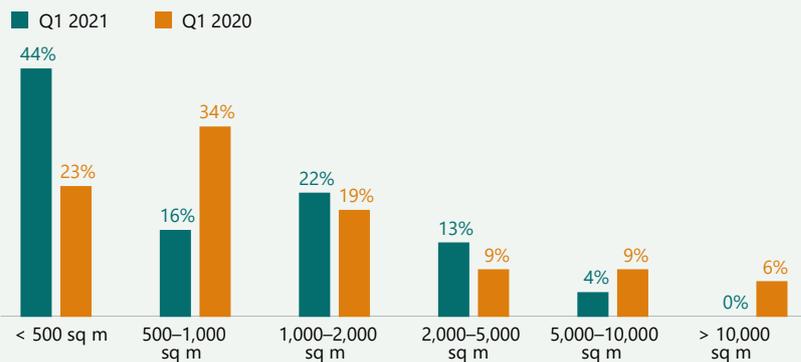
In the structure of demand for offices, companies in the TMT sector (Technology / Media / Telecommunications) were leaders in the first three months of 2021 with a share of 36.6%. The second place was taken by the sector of state-owned companies. The largest transaction of the period was the lease of more than 6,200 sq m of office space in the "Yuzhny Park" Business Center by "GKU Organizator Perevozok". The third place was taken by companies in the Retail sector, with a share of 11.0%.

Take-up structure by business sector



Source: Knight Frank Research, 2021

Distribution of leased office units by size



Source: Knight Frank Research, 2021

Key lease and sale deals in Moscow office market, Q1 2021

Company	Transaction Volume, sq m	Type of Transaction	Office Building
"GKU Organizator Perevozok"	6,228	Rent	Yuzhny Port
Sitronics ❖	5,959	Rent	RTS Volgogradsky
Yandex	4,960	Rent	Amalteya
AVON	3,271	Rent	15 Leningradsky ave., bld. 10
Internet Solutions	3,092	Rent	Imperiya
Vega Gas ❖	2,689	Rent	Art Gallery

❖ Knight Frank transactions

Source: Knight Frank Research, 2021

Business Terms

Against the market conditions observed, office rental rates slightly changed in Q1 of 2021. The asked rental rate in Class A offices for the quarter increased by 1.5% and is now at the level of 25,911 rubles/sq m/year (excluding operating expenses and VAT). In Class B, the rental rate also decreased slightly compared to the beginning of the year – by 0.8%, i.e. to 16,998 rubles/sq m/year (excluding operating expenses and VAT).

With regard to Class A spaces, if in 2020 the increase in the rental rate was mainly due to the entry into the market of large

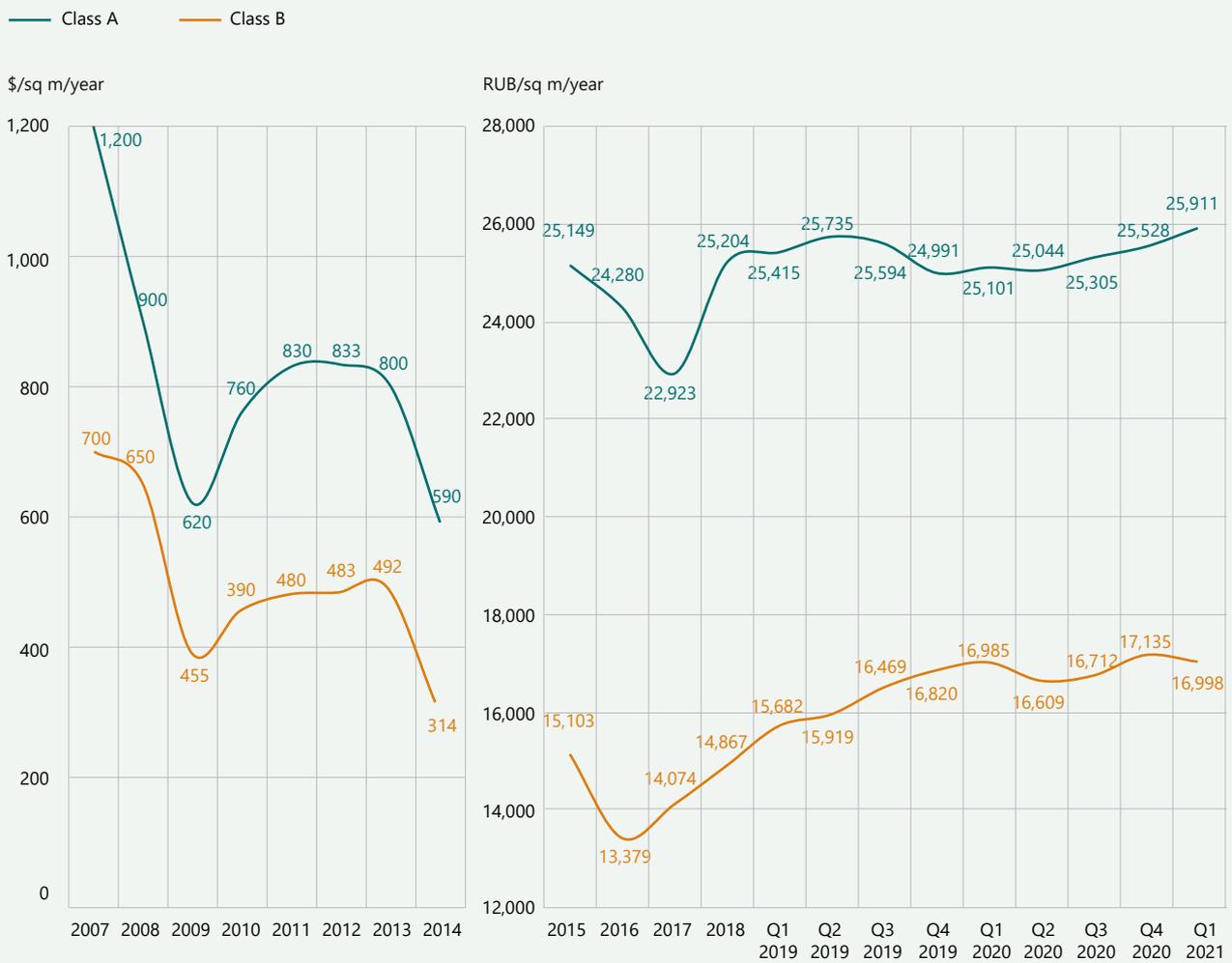
and expensive facilities that have been unfilled for a long time and still remain as such, now the growth is also generated by increasing the asked rates in a number of high-quality objects, where there is a small amount of space offered with fit-out or “after the departure of the tenant”. This trend is due to the growing demand for ready-to-move options that require minimal financial and time costs to arrange the space for residents.

No significant increase in the price of current vacant offices is expected in 2021. Moreover, in buildings with a high volume of vacant space, owners will be

more flexible in dealing with potential tenants in order to accelerate the sale of the current vacant space.

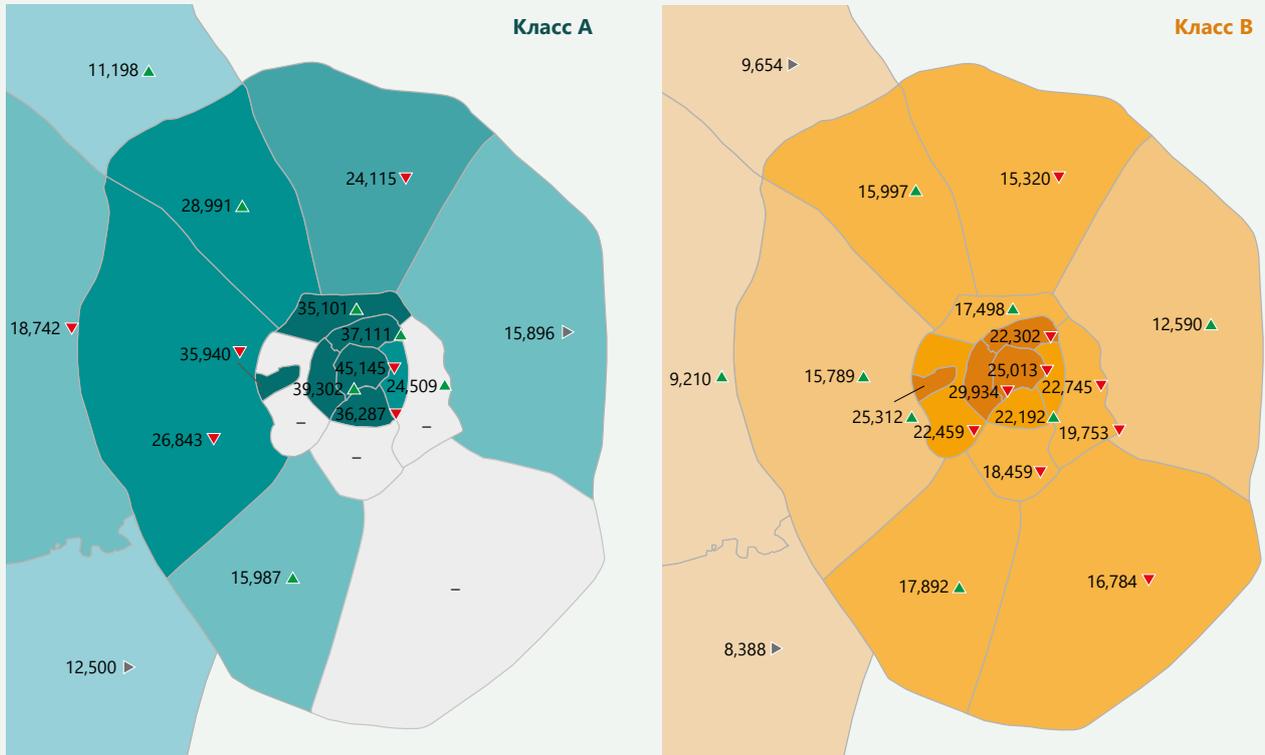
The existing market practices remain unchanged. The average term under office lease agreements is still 5 years with the possibility of early termination. The indexation of rental rates in most contracts is tied to the consumer price index but remains a reason for negotiations, since tenants and owners of business centers understand that rental rates and inflation rates may rise in 5 years.

Class A and B average weighted asking rents dynamics



Source: Knight Frank Research, 2021

Moscow submarket data. Average weighed rent



Source: Knight Frank Research, 2021

The area of the leased office unit is the main factor in the deviation of the achievable rental rate from the asked one: developers often prefer to lease a building to several large tenants instead of a mono-tenant or division of space into small units. This creates a stable rental income for them that is less dependent on rotation, on the one hand, and not so difficult to administer, on the other.

Offices are mostly leased “as is”, and compensation for finishing by the owner is often minimal or absent.

Forecast

In 2021, the commissioning of new facilities may amount to 650,000–750,000 sq m, where about 60-70% will be Class A projects. In the event of unforeseen adverse situations and low rates of market recovery, the indicator at the end of 2021 may turn out to be lower.

Due to the gradual recovery of the segment, the net absorption rate in 2021 is projected at 550,000–650,000 sq m, taking into account Rostec-City and Two Captains facilities.

The reduced construction activity in the past few years helped to avoid a situation similar to the recession of 2014, when over 1 million sq m of new space entered the market and the significant increase in vacancy was observed against a sharp drop in demand. Nevertheless, taking into account the sharply reduced demand for office space as well as the continuing uncertainty, a further increase in the vacancy rate share in Class A is expected in 2021. The figure may reach 13.1 – 13.3%. As for Class B, a moderate reduction is expected due to the small amount of offices announced for commissioning as well as the continued rental activity in this class: the vacancy rate at the end of the year will be about 5.7–5.9%.



Office Space Sales Market

The office sales market in the Moscow office market can be roughly divided into two segments: transactions to buy the so-called small-size “retail offices” (up to 500 sq m) and major purchases of entire buildings (which has seldom happened recently). In both cases, the space can be

used both for their own offices and for further leasing to other companies. At the same time, if when buying small offices the achievable sale price slightly differs from the asked one, then in the case of major purchases a significant price reduction will be possible in both Class A and Class B offices.

The average weighted price for office units in Class A facilities amounts to 231,975 rubles/sq m, in Class B offices – to 147,907 rubles/sq m, and in mansions – to 312,446 rubles/sq m. The average weighted price of general purpose area located on the ground floors of residential complexes is 144,483 rubles/sq m.

Moscow submarkets. Average weighted sale price*.

	Class A	Class B	Mansion	Premises for free use
Boulevard Ring	–	377,762	383,757	454,283
Garden Ring	305,664	205,576	344,016	310,879
Third Transport Ring	236,410	177,395	218,359	150,747
TTR - MKAD	201,031	123,838	230,146	109,147
Outside MKAD	129,600	85 166	–	100,097

* Excluding VAT (20%).

**Premises of open designation

Source: Knight Frank Research, 2021



Moscow submarket data. Key indicators*

Submarket		Lease Area, thousand. sqm	Class A				Class B			
			Average rent, RUB/sq m/year*		Vacancy rate, %		Average rent, RUB/sq m/year*		Vacancy rate, %	
Boulevard Ring	Central business district	712	45,145		5%		25,013		5%	
Garden Ring	South	999	36,287	35,914	10%	15%	22,192	25,853	7%	6%
	West	561	39,302		25%		29,934		8%	
	North	667	37,111		14%		22,302		6%	
	East	407	24,509		33%		22,745		1%	
Third Transport Ring	South	1,282	-	35,241	-	1%	18,495	19,964	8%	7%
	West	813	-		-		22,459		11%	
	North	987	35,101		2%		17,498		3%	
	East	1,133	-		-		19,753		4%	
	MIBC Moscow-City	1,233	35,940		7%		25,132		9%	
TTR-MKAD	North	1,052	24,115	22,013	4%	11%	15,320	15,763	4%	6%
	Northwest	888	28,991		15%		15,997		4%	
	South	2,234	26,843		4%		15,789		6%	
	West	1,454	-		-		16,784		3%	
	Southwest	662	15,987		7%		17,892		8%	
	Preobrazhenskiy	1,005	15,896		30%		12,590		6%	
Out MKAD	Khimki	266	11,198	15,119	15%	30%	9,654	9,294	9%	9%
	West	607	18,742		60%		9,210		11%	
	New Moscow	345	12,500		24%		8,388		2%	
Total		17,307	25,911		12.0%		16,998		6.0%	

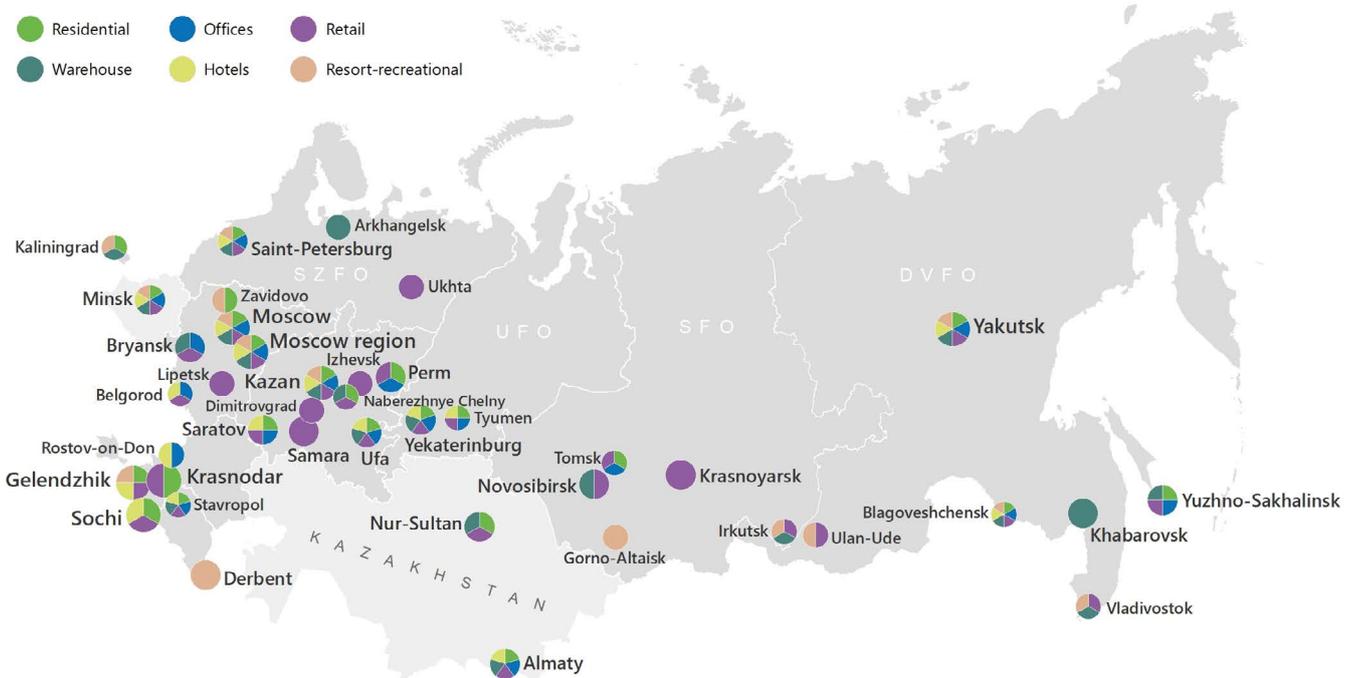
* Excluding OPEX and VAT (20%)

Source: Knight Frank Research, 2021

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Olga Shirokova
Director, Russia & CIS
OShirokova@kf.expert

REAL ESTATE VALUATION

Olga Reshetnyakova
Director, Russia & CIS
or@kf.expert



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Maria Zimina
Director
mz@kf.expert