

The total volume of office completions in H1 2021 exceeded the total completion of 2020 twice and amounted to **446.3 thousand sq m**

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OFFICE MARKET REPORT. MOSCOW

H1 2021

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«2021 continues to delight with the high activity of tenants: transactions for more than one floor of Class A real estate are often concluded. Moreover, such transactions are not just moving companies, but new jobs, which is net absorption. Most of the 2021 records are deferred demand of 2020 and the effect of space reformation by tenants due to the hybrid operation format.

Flex offices continue to be popular this year. They are considered even by state-owned companies, which usually tend to be critical about non-classic office formats. It is worth noting that due to the high activity of tenants and low construction rates in previous years, the choice for tenants will be limited both this year and next 2022, while new business centers with a large area within the Moscow Ring Road will appear on the market only in 2023—2024. The supply shortage will increase the price in addition to the construction cost growth. However, let us hope that the increase in rates will not be a temporary phenomenon until the scheduled large constructions are completed».

Key conclusions

- ♦ The total volume of office completions in H1 2021 exceeded the total completion of 2020 twice and amounted to 446.3 thousand sq m.
- ♦ The vacancy rate at the end of H1 2021 reached 10.8% in Class A offices and 5.8% in Class B offices.
- ♦ Asked rental rates at the end of H1 2021 amounted to 26,038 rubles/sq m/year in Class A and 17,304 rubles/sq m/year in Class B.

Key indicators. Dynamics*

		2020	H1 2021
Total stock, '000 sq m		16,998	17,444
	Class A	4,594	4,939
	Class B	12,404	12,505
New supply, '000 sq m		224	446.3
	Class A	129.7	344.5
	Class B	94.7	101.8
Vacancy rate, %	Class A	11.7	10.8
	Class B	6.1	5.8
Average weighted asking rental rate*, RUB/sq m/year**	Class A	25,528	26,038
	Class B	17,135	17,304
OPEX rate range*, RUB/sq m/year	Class A	7,100	7,100
	Class B	4,800	4,800

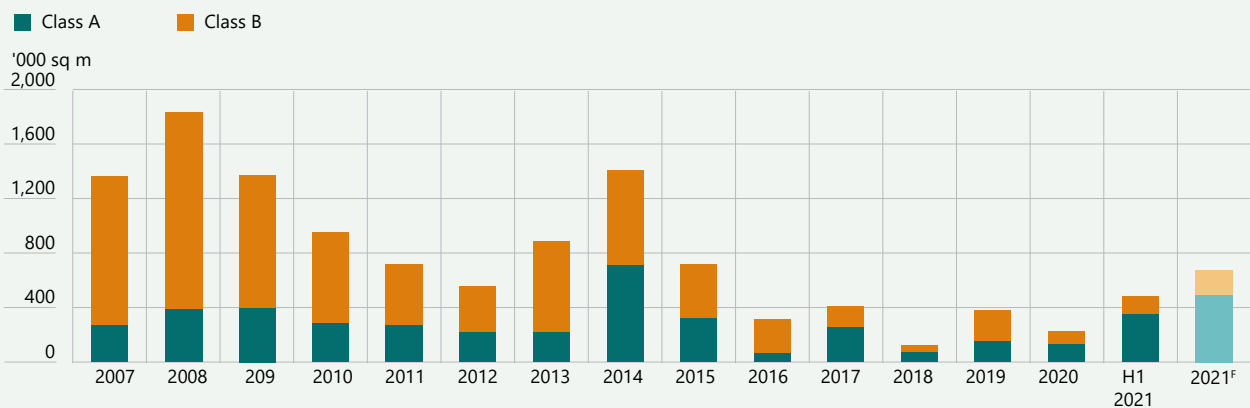
* Compared to Q4 2020

** Net of operating expenses and VAT (20%)

*** The category of Prime Class facilities is distinguished in Class A. It includes the highest quality, efficient in terms of layout, high-tech buildings located in the most developed and significant business clusters of Moscow (Central Business District, Belorussky Business District, Moscow City). The basic average weighted rental rate is 43,632 rubles/sq m/year

Source: Knight Frank Research, 2021

Class A and B new supply dynamics



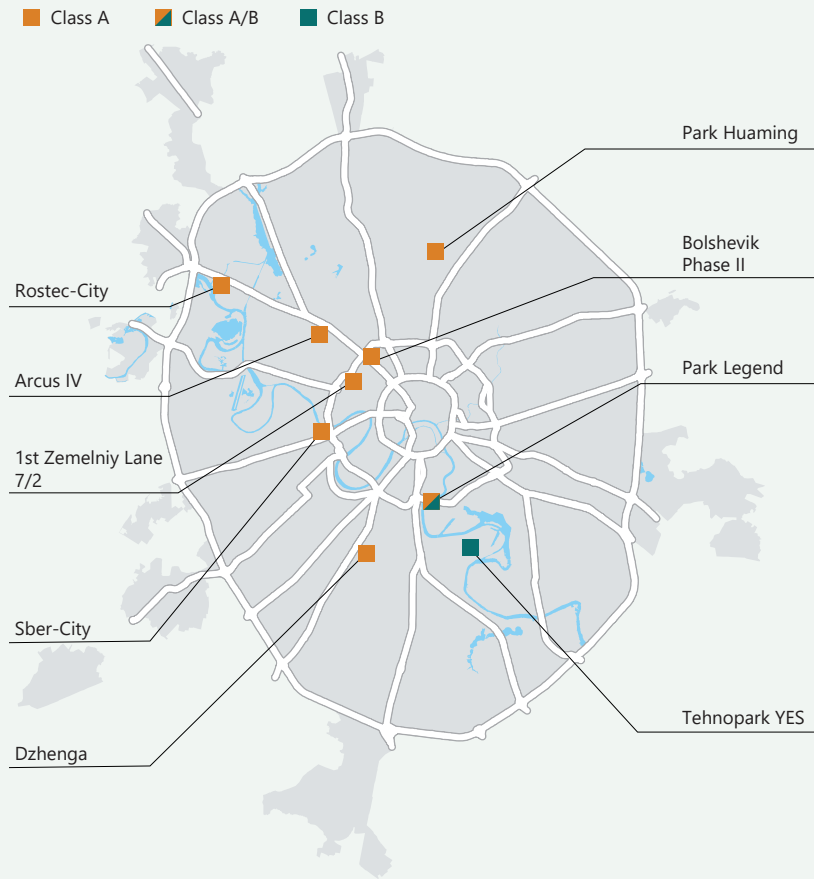
Source: Knight Frank Research, 2021

Supply

At the end of H1 2021, the total office space in the Moscow market amounted to 17.4 million sq m, including 4.94 million sq m of Class A and 12.5 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 446,000 sq m completed at once in H1 – more than total area in 2016–2020. 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. Over 128,000 sq m of the leasable area of Sber-City facility in Kutuzovskiy Avenue were officially commissioned. Among the projects commissioned, “Two Captains” Business Center with its leasable area of 79.8 thousand sq m and “Arcus IV” (18,000 sq m) may also be noted. Despite the large areas of new facilities, there was no strong growth in the vacancy rate: Rostec-City and Sber-City were constructed for the needs of Rostekh and Sberbank, respectively, and “Two Captains” Business Center did not enter the speculative market either, since it was built for government structures that will have their offices there. In fact, half of the vacancy among the new supply is formed by the areas of “Arcus IV” Business Center, which was commissioned in Q1 2021.

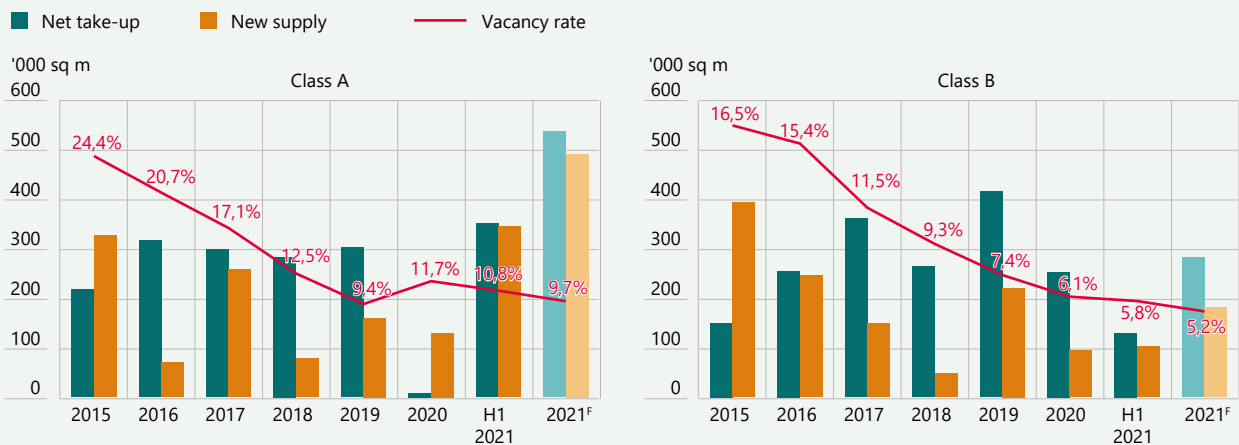
Map of Facilities Scheduled for Commissioning in 2021*



* 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.

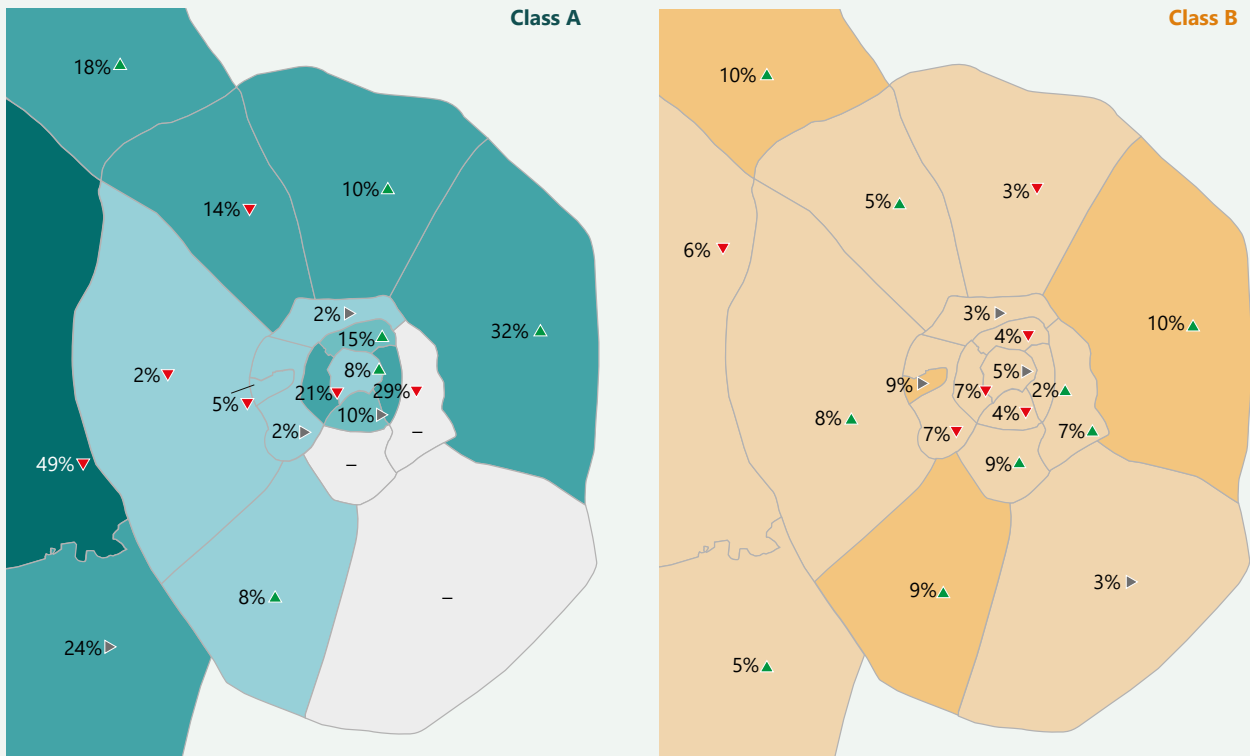
Source: Knight Frank Research, 2021

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 220,000 sq m is expected in 2021. Taking into account H1 2021 outcomes, the cumulative result of the year may exceed 650,000–690,000 sq m, which will be the maximum over the past seven years. At the same time, more and more built-to-suit facilities will appear on the market.

The vacancy rate in Class A has reduced by 1 ppt to 10.8% since the start of the year. Currently, about 530,000 sq m of offices remain vacant. The change rate is at around 5.8% in Class B, which is 0.3 ppt lower than at the end of 2020: the total vacancy is almost 730,000 sq m. The factors of such dynamics of indicators are the high level of rental activity in the first half of 2021 – the share of new lease transactions in the structure of transactions is growing, forming a high indicator of office absorption. It is also worth noting the fact that over 85% of the commissioned facilities are projects constructed for corporations, and only a small speculative part of the commissioned facilities appeared on the market, most of which was formed



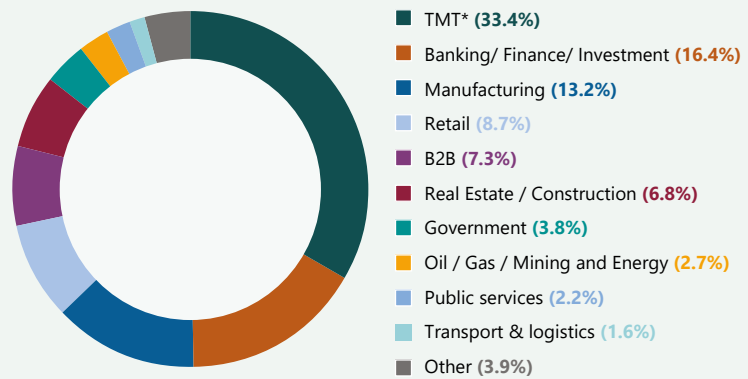
by the “Arcus IV” project (17,975 sq m), which turned out to be unfilled. The figure is expected to further decrease by the end of 2021: to 9.6–9.8% in Class A and to 5.1–5.3% in Class B facilities.

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. In H1 2021, there is already much of activity in the conclusion of new lease agreements: the share of such transactions amounted to 53% against 47% 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 vacant — has grown significantly in H1 2021 and amounted to 481.2 thousand sq m against 262.1 thousand sq m at the end of the entire 2020. The absorption figure growth is associated both with increased activity of office users, that not only change their office locations but also increase the area occupied, and with the appearance on the market of BTS buildings created for a specific user and entering the market full. Moreover,

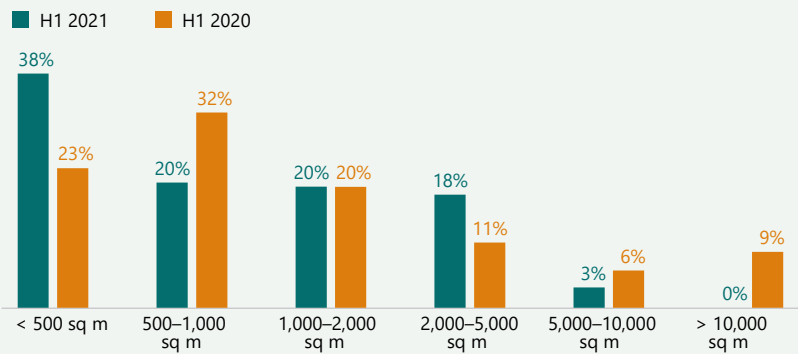
Take-up structure by business sector



*(Technology/Media/Telecommunications)

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, H1 2021

Company	Transaction Volume, sq m	Type of Transaction	Office Building
Sovcombank	9,049	Lease	7/2, 1st Zemelny Lane
GKU Organizator Perevozok	6,228	Lease	Yuzhny Port
Sitroniks	5,959	Lease	RTS Volgogradsky
Yandex	4,960	Lease	Amalteya
AVON	3,271	Lease	15 Leningradsky ave., bld. 10
Internet Solutions	3,262	Lease	Mercury (Space 1)
Internet Solutions	3,092	Lease	Imperia
Vega Gas	2,689	Lease	Art Gallery
Internet Solutions	2,437	Lease	Gorod Stolits
Internet Solutions	2,250	Lease	Federation Tower

🔴 Knight Frank transactions

Source: Knight Frank Research, 2021

fairly large transactions in terms of the area are noted, which is associated with the expansion of large corporations that have not yet chosen or built their own headquarters, e.g., Ozon and Yandex, as well as structures associated with Sberbank. It is expected that IT companies will take a significant part of absorption in the near future.

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 33%. The second place was taken by the sector of Banks/Finance/ Investments with a share of 16%. The average lease transaction amounted to 1,549 sq m in H1 2021.

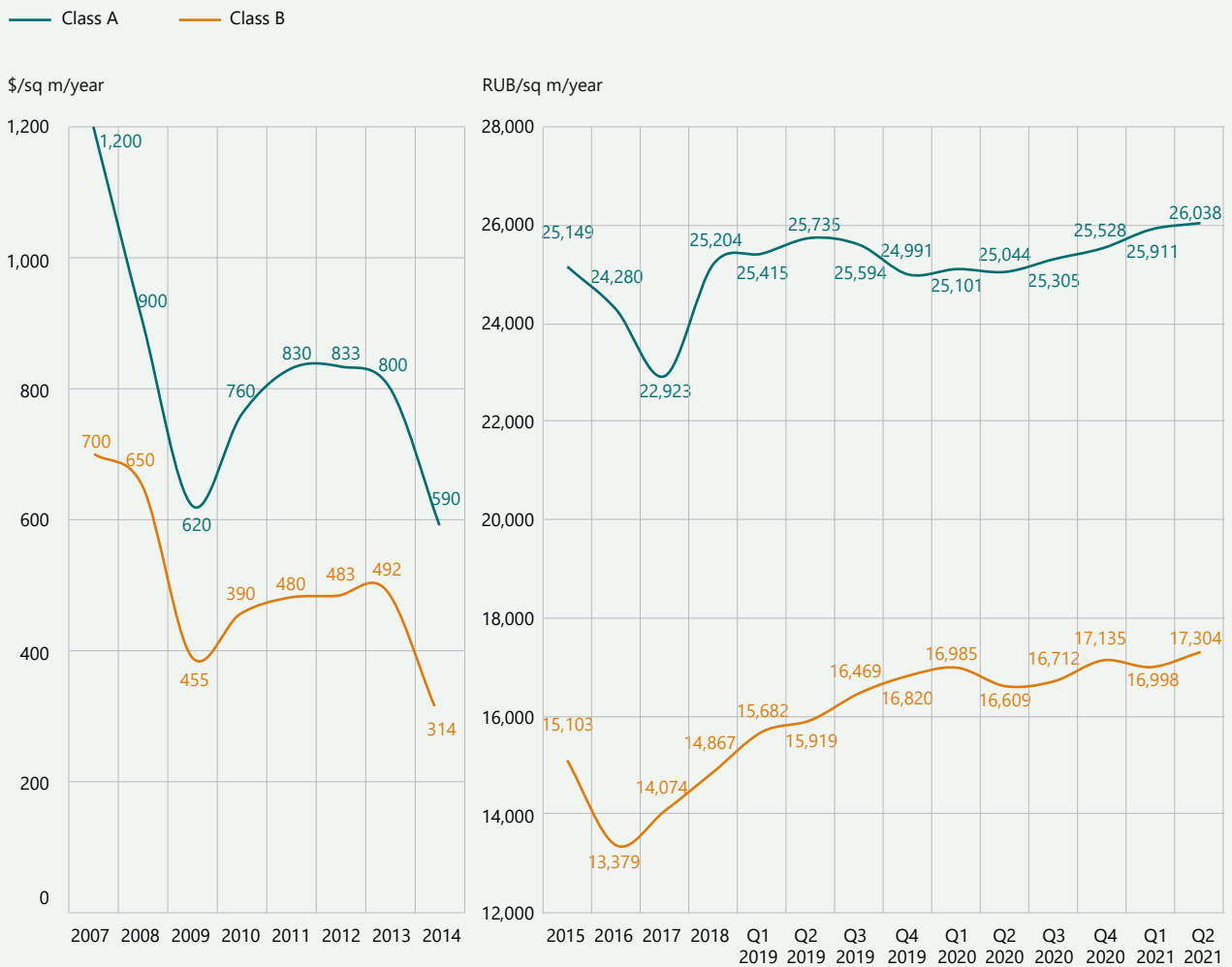
It is worth noting that the share of preliminary lease transactions has increased among new lease transactions: companies sign office lease contracts even before the facility officially obtains a permit for commissioning. In particular, the current largest transaction of 2021, the lease of more than 9,000 sq m of the facility at 7/2, 1st Zemelny Lane, by Sovcombank, was a preliminary lease. Large lease transactions for flex offices were also noted in H1 2021. Despite the fact that earlier this sector was usually chosen by the TMT companies, more and more corporations representing different segments are choosing such a placement format. The flex office market continues to grow at a significant pace, with new professional flex space operators

emerging, including FLEXITY and Pridex, which are the most recent major players in the segment.

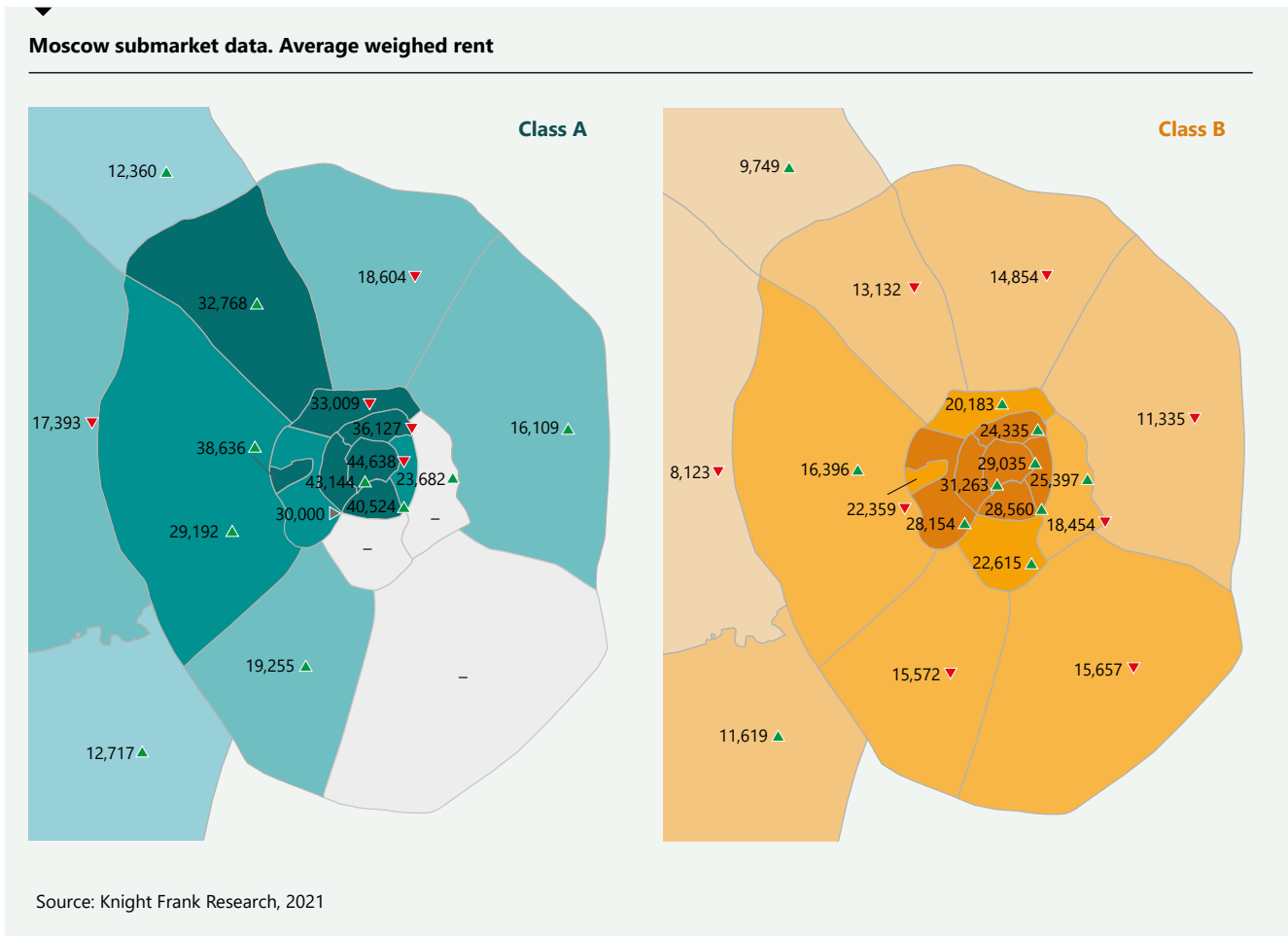
Business Terms

Against the market conditions observed, office rental rates slightly changed in H1 2021. The asked rental rate in Class A offices increased by 2.0% compared to the beginning of the year and is now at the level of 26,038 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 1%, i.e. to 17,304 rubles/sq m/year (excluding operating expenses and VAT).

Class A and B average weighted asking rents dynamics



Source: Knight Frank Research, 2021



If previously the growth in rental rates was mostly market-based and was due to increased tenants' activity and a shortage of high-quality facilities in key business areas, now the growth is also due to an increase in the construction cost, which will particularly affect business terms in new projects that will appear on the market in 2023–2024.

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.

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 650,000–690,000 sq m, where almost 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 segment recovery, the net absorption in 2021 is projected at of 790,000–830,000 sq m.

Despite the potentially high rate of new construction, the vacancy share in both classes will not increase but, on the contrary, will decrease to 9.6–9.8% in Class A and 5.1–5.3% in Class B due to significant area constructed for specific structures and corporations, as well as a large number of new lease transactions. In the near future, the share of built-to-suit buildings will grow.

We can expect an increase in rental rates in the nearest 1–3 quarters due to high rental activity and growth in the new construction cost.

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	44,638		8.4%		29,035		4.6%	
Garden Ring	South	999	40,524	34,786	10.3%	14.2%	28,560	28,796	3.6%	4.4%
	West	561	43,144		21.0%		31,263		6.5%	
	North	667	36,127		15.1%		22,376		4.2%	
	East	407	23,682		28.7%		25,397		2.0%	
Third Transport Ring	South	1,282	-	31,184	-	1.5%	22,615	22,766	8.8%	6.8%
	West	813	30,000		2.5%		28,154		7.2%	
	North	975	33,009		2.1%		20,183		3.1%	
	East	1,142	-		-		18,454		6.8%	
	MIBC Moscow-City	1,233	38,636		4.8%		22,359		9.4%	
TTR-MKAD	North	1,063	18,604	22,732	9.6%	9.3%	14,854	14,352	3.0%	6.4%
	Northwest	1062	32,768		14.1%		13,132		4.6%	
	South	2,200	29,192		1.6%		16,396		8.2%	
	West	1,454	-		-		15,657		2.7%	
	Southwest	662	19,255		8.3%		15,572		9.4%	
	Preobrazhenskiy	1005	16,109		32.1%		11,335		9.9%	
Out MKAD	Khimki	266	12,360	15,243	18.2%	28.0%	9,749	9,352	10.2%	7.4%
	West	595	17,393		48.8%		8,123		6.0%	
	New Moscow	345	12,717		24.1%		11,619		5.1%	
Total		17,444	26,038		10.8%		17,304		5.8%	

* Excluding OPEX and VAT (20%)

Source: Knight Frank Research, 2021

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