Russian property developer totals for 2013

The commercial real estate market in Russia: condition, trends and prospects

By Armen Danielyan

GGI member firm Delovoy Profil Audit & Consulting Group experts have conducted a market analysis of the commercial real estate market for 2013. The figures for the market are evidence of the fact that the last year has proven to be very lucrative for Russian property developers. As a whole, investments in residential and commercial real estate have fallen by 7.5% in the past year since 2012, down to total USD 8.1 billion. Despite this, property developers nevertheless consider 2013 to have been successful, as all records had been broken with a great resurgence in demand in 2012, following the financial crisis of 2008 and 2009.

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Traditionally, typical growth indicators have been distributed to Moscow and St. Petersburg: 84% of investments have been attributable to the Moscow real estate market and 6% to St. Petersburg. The main segments of investment interest have been offices (36.8%), commercial centres (37.4%), and warehouse facilities (14%). Our experts have noted that the growth rate for investment in warehouse facilities has doubled. This has principally occurred due to federal retailers' activity in the regional markets and their expanding commercial networks throughout Russia.

In today's commercial real estate, alongside evident stabilisation, it is also worth noting the growth in the interest of foreign investors. In 2013, a deal with a quantity in excess of one billion dollars was put in writing for the first time on the Russian commercial real estate market: American corporation Morgan Stanley acquired the Metropolis commercial centre for USD 1.2 billion. Other large deals noted by our experts have been the purchase of the White Gardens business centre by Millhouse Capital for USD 740 million and the Radisson Moscow Olympic by Azimut Hotels for USD 120 million. The grand total of foreign investments in Russian real estate in 2013 amounted to USD 3.7 billion, or 46% of all investments.

The size of investments in Russian commercial real estate has remained stable throughout 2011 and 2012 at around USD 8 billion per year. By comparison, prior to the economic downturn, this figure amounted to around USD 4-5 billion per year from 2006 to 2008.

As asserted by our experts, the interest of foreign investors is evidence of the fact that today's commercial real estate

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market in Russia has not yet hit its peak and is considered to have positive prospects. Correspondingly, investment in this segment in the upcoming few years promises to be profitable and prosperous.

The stable growth of prices on the Moscow commercial real estate market is continuing at present, stimulating investor interest. There are absolute figures pointing to the fact that the peak in prices has not yet been hit and they still have scope to rise. In August 2008, before the economic downturn, the cost of a square metre of commercial real estate in Moscow was USD 5,200, but by August 2013 it had fallen to just USD 4,300. Meanwhile, the commercial real estate market was hit hardest by the 2008 to 2009 economic downturn. Sellers cut their prices by 50% just to complete projects they had already started, the majority of which was paid for by funds loaned from banks.

What to expect from the commercial real estate market in 2014

According to our experts, property developers are generally retaining an optimistic stance on the future of the Russian commercial real estate market in 2014. They expect to see a steady rise in prices, especially in the capital and in large cities with populations of more than one million. Retailers' activity in some regions of Russia gives rise to positive effects for interest in commercial and warehouse facilities, and not only in large cities, but also in population points of 200 thousand people or more. Our assumption is that the Moscow segment of commercial real estate will continue to develop, primarily due to an increase in the quality of commercial objects being built and changes in the style of construction. We continue to see ever more markets being closed and higher quality commercial centres erected in their place. Another element in the development of the given market segment is the development of transport hubs along with the commercial facilities.

The main threats to the market, our experts claim, stem from delays in the growth rate of the Russian economy and a certain deficiency of objects for investment in Moscow, especially in the office real estate segment. Our consultants note that office buildings with car park facilities are enjoying the highest demand from buyers. The issue of organising parking in light of changes in parking rules in the city is particularly relevant. For this reason, business is predicted to see a spread out towards the suburbs of Moscow into business centres created specifically for this purpose with quality office facilities. Furthermore, many large raw material companies have already spoken about relocating their general headquarters to outside regions. If such relocation does occur, and is not limited by a change in legal address, it could lead to falling prices for office buildings in the capital. In our opinion, the formation of a large quantity of high-quality centres in the given market segment, which has been observed over the past two years, might prove to be additional factors causing price stagnation for office real estate and this trend looks set to continue in 2014. Analysts have already observed a decline in the demand for office property in 2013 (by 10%), which occurred in light of increased new construction. Given that the rate of construction of new offices in Moscow continues to exceed existing demand, pressure from this factor may also take a toll on the general level of prices for office buildings in the capital.

Nevertheless, on the whole, our experts predict a rise in prices for commercial real estate in all segments and therefore a rise in investment in the sphere for the next few years. Based on objective evaluations of the current state of affairs of the Russian real estate market, it could be concluded that it has not yet exhausted its growth potential and not yet left the warm-up stage before its next peak, after which there will be a consistent decline in prices. Currently, analysts have observed growing demand, which was delayed as a result of the 2008 financial crisis.

This expert overview has been prepared by Delovoy Profil Audit & Consulting Group analysis department specialists on the basis of market data analysis and extensive, practical work experience with various sector representatives, including construction, property development and other companies.

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