

Property Management Is Coming

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External professional property management is at the development stage in Russia. The share of external management companies is estimated at 5 percent of the commercial property market. Owners prefer to run property by themselves and outsource only part of the services (cleaning, security, engineering systems servicing). Proprietors do not entrust external managers with the financial part of management.

The reason for the lack of property management service on the Russian market is based on the overall low level of trust in the local business sphere, the lack of business practice of trust management, and opaque financial flows (incoming and outgoing).

Proprietors want to receive long-term revenue guarantees from management companies, but these guarantees are impossible because of market instability. Nevertheless, the property management issue is one of the most discussed on property forums.

Owners' interest in external management was encouraged by the financial crisis of 2008-09. Before, most developers did not have to compete for leaseholders. Properties were bought up at the ditch stage, so lease managers' work consisted of collecting rent payments. High rental wage allowed owners not to take into account operational costs. By the beginning of 2009, rental rates fell 30 percent to 35 percent, and the share of unoccupied space increased 20 percent to 30 percent on the office real estate market.

In some business centers, 80 percent of offices were empty. Many banks, which in the past had never run property management, unexpectedly became property owners as developers were unable to repay debts. That was the reason for the boom in demand for professional management companies services. But while cautious negotiations were in process, the situation stabilized.

By mid-2009, rental rates for class-A office space fell from the record \$1,200 per square meter a year to \$600 to \$650. By mid-2011, prices virtually returned to the pre-crisis level.

The share of free spaces decreased 7 percent to 8 percent in the range of the Garden Ring and 16 percent to 18 percent in the range of the Third Ring Road. Thereafter, the question of external management was not a matter of life and death anymore. Furthermore, practically all big owners created their own management companies that somehow met their requirements.

Nevertheless proprietors proceeded to show interest in management company opportunities due to their own poor results in this sphere. For example, even during the crisis, KR Properties did not have more than 7 percent free spaces and rental rates were 20 percent more than the market average. The company succeeded in the creation of an image for its leading real estates — the Red Rose 1875 and Danilovskaya Manufacture 1867 business centers, which allowed them to attract reputable leaseholders and set high rental prices.

The company has 500,000 square meters in operation, which makes it possible to have

a wholesale discount on operating supply (lamps, sanitary ware, cleaning materials, etc.). One emergency crew services 10 properties, and one engineer — three to five properties. When considering undertaking the management of an office building, we take into account that with a professional management company running costs will be 15 percent to 20 percent lower than if the building is managed separately.

On the property management level, every big management company has the advantage of experience in involvement and retention of leaseholders with the help of a professional team and collaboration with broker companies. The top management companies cannot fill office areas of any building faster and more profitably than the owner. The benefit of working on the property management level can be estimates at 15 percent to 20 percent of the revenue.

The potential of the external management market is estimated at \$500 million. But this depends on the speed of market growth. At the moment, this is a very slow process, but another expected round of the crisis will stimulate owners to collaborate with management companies.

It is still not too early to speak about asset management and building management on the market level, though KR Properties and other big companies offer these services and can present impressive results. This is the business of the future.

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