

Market Will Remain at Current Levels for the Foreseeable Future

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In spite of cold weather and gloomy skies, the business season has opened with more activity on the real estate market than many expected. While the supply of new commercial space remains stable and low, tenant activity is moderate to high, which is higher than expected.

While August was unusually quiet, as most of the decision makers were away from Moscow and their offices, September might improve the 3rd quarter results for 2012. Most of the tenants requested offices between 100 sq. m. and 400 sq. m., with the next most popular category being 400 sq. m. to 1,000 sq. m. Most of the requests, almost 80 percent, came from businesses already operating in Moscow; those tenants were looking to upgrade their space rather than get a larger space or start new businesses or projects.

For the year to date, the rental rates in Moscow remained flat, demonstrating no upward or downward dynamic. Today, as throughout 2012, one can expect to pay approximately \$1,200 per square meter per year in a premium, centrally located Class A building, \$780 per square meter per year in a Class A building outside the center, and \$500 per square meter per year in a Class B building. All these numbers are exclusive of VAT. For many smaller tenants and landlords, VAT doesn't affect the rental rates due to extensive use of the simplified tax reporting option for small- and medium-sized businesses.

Such rental rate stability prompted commercial landlords to offer quality long-term tenants incentives to sign long-term contracts and keep them from moving. This is drastically different from the previous years, where long-term contracts (over 11 months) had to be fought for, especially by small tenants.

Interestingly enough, attracting the best talent and retaining current employees was cited third among the reasons to change offices and upgrade the company's office space. Diminishing supply of high-quality workers and competition for employees in some

industries is affecting not only compensation and benefit packages, but also other business decisions, including choosing or upgrading the office space.

This supports the dominant view of the industry players that Moscow's commercial real estate market has entered a new plateau. Most businesses are cautious of another crisis and have no appetite for risk, expansion or new projects. Such cautious behavior is not unique to Russian businesses and "conserve and wait" seems to be the dominant strategy in Europe, which continues to suffer from the debt crisis. Russia in general and Moscow in particular has a relatively lower debt to GDP ratio and unemployment rates, with the Moscow region virtually at 0 percent. Therefore, it is most likely political, country specific risk that keeps businesses from investing. As there is very little hope that the political environment will change dramatically in the coming year, we expect the market to remain at current levels until the end of the current and for the coming year, unless the Russian economy experiences major external shocks or falls into internal political turmoil.

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