

RUSSIAN REAL ESTATE

EARLY BIRDS TAKING THEIR PICK OF THE COMMERCIAL PROPERTIES

Western European investors should look beyond the political risks of the Yukos affair, as Russia offers excellent opportunities, particularly in real estate

Helped by both political stability and economic growth, Russia has been something of an investors' heaven over the last year. But it remains important for investors to apply correct risk management filters.

On the political side, President Vladimir Putin introduced much-needed law and order, centralising power in the hands of federal authorities, reforming the legal system and bureaucracy.

Structural reforms are underway, with more emphasis



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Dmitri Chibisov, GLOBEXBANK

on boosting competition and creating a better climate for foreign investors. The state is also introducing more transparent legislation and taxation systems.

Parliamentary and presidential elections in the coming winter and spring are not expected to bring many changes to Mr Putin's vision, though foreign investors are likely to wait until a new government has been formed.

On the economic side, the International Monetary Fund forecasts Russia's gross domestic product to rise 6.3 per cent in 2003, up from 4 per cent in 2002, outperforming most mature economies.

Due to high prices, oil revenues, which comprise 50 per cent of the economy, have poured into the Russian stockmarket. As a result, RTS, the Russian Trading System index rose 60 per cent since the beginning of the year and reached historical highs in October. Moody's upgrading of Russia's external debt by two notches to Baa3 has provided a further boost.

Our strong belief is that Russian equities could account for the entire 10–12 per cent of an investor's portfolio earmarked for emerging markets.

» YUKOS IMPACT

Developments surrounding the Yukos affair may have caused a drop in share prices, but this will blow over within three months, as Yukos is seen to concentrate on its core activity of producing oil and gas.

Yukos oil licences are under investigation by the Ministry of Natural Resources, and this may grate on the nerves of foreign investors, but it is normal practice in Russia, where federal clerks typically mix business with politics. Public warnings from the deputy general prosecutor are a further illustration that Russia's top authorities believe it's open season on the "oligarchs".

Investors should be more concerned with other unconnected political and economic risks, such as revision of property rights after a presidential election, or a fall in oil or gas prices, which would hit an economy highly dependent on these two major exports.

» OPPORTUNITIES

Investment opportunities in Russian equity and fixed income are also fairly limited, with few listed companies and bonds, and a low free-float for those which are listed. Moreover, the blue chips – oil stocks – are becoming too expensive for many investors. The second-

tier stocks may be cheaper but less transparent and thus riskier.

This is why many investors are looking at Russian real estate, which provides attractive yields and high capital appreciation potential.

Although both equity and property markets are considered high risk areas, Russian equities are more volatile due to their speculative nature, compared to property. Again, the Yukos affair is good proof of this.

The property market on the other hand, is affected to a greater extent by the country's macroeconomic situation. This will not be affected by Mikhail Khodorhovsky incarceration, provided government attacks do not spread to Yukos itself. The fact that the European Bank of Reconstruction and Development plans to increase its Russian investment portfolio from \$1.2bn (€1bn) next year supports this view.

» ATTRACTIONS

Moscow office real estate yields range from 15 to 19 per cent, two to three times higher than other European markets and twice as high as Russian government and corporate fixed income yields.

Investment in new construction in Russia during 2002 totalled \$26bn, with 13 per cent of that in Moscow, the country's largest and most transparent property market, with well-established procedures regarding real estate investment.

De facto, investments in Russian commercial real estate mean investments in Moscow city or the Moscow region, which draws the greatest concentration of wealth and business activity.

Moscow offers a choice of investments. Firstly, there are those demanding high investment, commanding equally high rents, usually situated in the city centre. There are also B or even C-class investment projects, which are cheaper and can command lower rates, but situated in very populated suburbs, with access to millions of customers. GLOBEXBANK has classified investments into business and shopping centres as projects of the highest importance, particularly

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A and B-class office and trade centres.

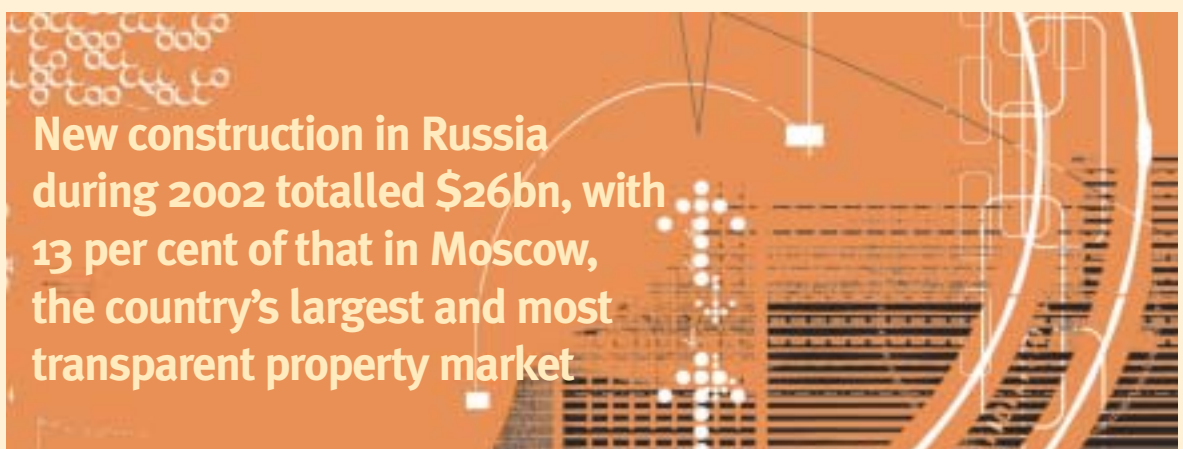
Novinsky Boulevard is an A-class business and trade centre to be open before the end of this year. It has a total area of 80,000 square metres, with retail space of 10,200 square metres. Most space has already been leased at an annual rent of \$1000–\$2500 per square metre. It consists of six floors of offices and two floors of underground parking.

GLOBEXBANK originally chose Novinsky as a building to locate its main office, but ended up becoming the principal investor, putting in \$100m. The bank plans to see a profit of \$20m as early as the first year.

The B-class shopping and recreation mall is located in Kashirskoye Shosse, 63 in South Moscow, where the population reaches 1m, but the penetration rate of shopping and recreation facilities is one of Moscow's lowest.

The 40,000 square metre mall will include a hypermarket, stores, boutiques, offices and parking. Construction begins in the fourth quarter of 2003 with launch forecast in the fourth quarter of 2005. The total investment to be made is \$40m, with a projected payback period of three and a half years.

Moscow retail and office developments have the necessary scale to allow for risk diversification both in terms of properties and tenants. For instance, Stiles & Ryabokobylko, Russia's largest commercial real estate



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services provider, can offer around 40 retail and office projects with areas ranging from 180 to 54,000 square metres, with rents of between \$310 to \$1200 per square metre.

The buildings are situated in Moscow's centre or close by. There are also some 25 industrial and land sites.

» BUSINESS CENTRE

But by far the most impressive is the Moskva-City office, hotel, retail and recreation centre, the first of its kind in Eastern Europe. It is designed as the new centre of business in Moscow, whereas commercial activity is currently scattered all over central Moscow. Moskva-City has already been compared with "La Defense" in Paris and is seen as becoming one of the city's landmarks, symbols of innovation and integration in the global economy.

Moskva-City occupies some 100 hectares in the centre of Moscow, of which 60 hectares will be covered in construction. It is equipped with the most up-to-date telecommunications and transport network. A mini-metro line will connect it to the main metro network. There will also be special express trains connecting it to the train stations and airports.

The city of Moscow offers tax breaks and special rent and other offers to investors in the project.

On a lower, cheaper scale, Garant-Invest Realty offers five B and C-class investment projects in trade centres in residential areas of Moscow, which need \$55m of total investment.

» ACCESSIBILITY

Until recently the Russian real estate market has been inaccessible to Western portfolio investors. However, that is changing and the early birds are already here. Such prominent Western companies as Germany's Siemens AG and the UK's Fleming Family & Partners Russia Real Estate Ltd invested €100m and \$30m respectively in Moscow's office buildings.

Many funds are being created especially to cater for foreigners who wish to invest their money in commercial property in Russia.

Most analysts say that with more than a decade of development and precedent-setting deals, the real estate market in Russia is now mature and attractive enough for portfolio investors to enter. Contrary to



'Commerical real estate should go up nine times in Moscow before it reaches the European average'

Yuri Luzhkov, Mayor of Moscow

popular wisdom, land property rights in Russia are relatively secure, and enshrined in the country's civil code and constitution. There is also significant case law and procedures in place that make buying, owning and selling real estate fairly routine, particularly in Moscow.

Analysts forecast a great future for this class of asset, which already has both attractive yields and high capital appreciation potential. As the country's credit rating has been upgraded, an inflow of foreign investors in the real estate market is forecast, first boosting the yields to as high as 20 per cent in the next three years as demand grows and later stabilising at 12 per cent. It will still be higher than the 8-9 per cent in other East European countries such as Poland and the Czech Republic.

Illustrating the market's potential, Moscow mayor, Yuri Luzhkov, has said that commercial real estate should go up nine times in Moscow before it reaches the European average.

Western investments into property are increasing, alongside the decrease in profitability of equity and financial markets. Russian banks have developed sophisticated risk management systems in order to attract these investments. This goes hand in hand with the development of regional investment funds registered both in Russia and abroad.

*Dmitri Chibisov, head of project financing department,
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» CORPORATE STATEMENT

Since founded in 1992, GLOBEXBANK has grown to become one of the largest banks in Russia, offering a complete range of services to corporate clients, banks and private individuals. This year the bank announced its intention to set up a financial group of 8-10 banks. Presently, the group includes AvtoVAZbank (Tolatti), Rosinbank-SIBIR' (Novosibirsk), Yuzhny Region Bank (Rostov-on-Don). GLOBEXBANK financial group manages assets totalling \$1bn. The Group employs more than 2000 people in six regions across the country.



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