Saint Petersburg Real Estate Barometer

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Photo: CRE archive, Charts presented by KTI Finland

The commercial real estate market participants share a rather optimistic mood, forecasting the dwindling vacancy rate and rising rents in all market segments during 2011, albeit with some adjustments.

The results of the poll that for the first time was conducted by research and analytics company KTI Finland in February-March of this year in Saint Petersburg (similar studies in the Finnish real estate market have been done by KTI Finland since 1995) reveal that expectations of professionals from real estate become more positive. CRE North-West acted as an information partner of the project. The KTI St. Petersburg Property Barometer survey (expected to be held twice a year in St. Petersburg) involved 35 experts representing different real estate market sectors, such investments, development, management, consulting and brokerage. The respondents expressed their opinion about the development of St. Petersburg real estate investments and lease markets. In their opinion, the lease market is gradually recovering in all segments. During the past six months the vacancy has gone down while rental rates have remained at the previous level or slightly grown.

Offices

More than 70% of respondents suppose that the vacancy rate in Grade A and B business centers will further drop. Expectations of rent dynamics also remain optimistic – more than 60% of the experts are confident in their moderate rise until the year end. "Thanks to burgeoning demand and rather modest growth of supply in recent half year, the vacancy rate in A-grade business centers has gone down to 17% and in Grade B – to 15%. Most facilities are 90-95% full while others are occupied only by 50% and less," comments Natalia Kireeva, senior analyst of Maris Properties/CBRE.

In the words of Yaroslav Kataev, COO of Ruric Management whose assets include three top-notch business centers in central Petersburg (Oscar on Fontanka Quay plus Ruric and Magnus on Vasilievsky Island), vacant areas in these business centers have contracted in recent half year, albeit insignificantly. Now negotiations with a large tenant have entered the final stage – if they succeed the vacancy rate may decrease by another 25%. "During the recent half year the level of rental rates at our facilities has remained unchanged. Their indexation is not what we are concerned about at present. Our best efforts are focused on raising the level of comfort and a range of services for our tenants," adds Mr. Kataev. Yet like most other experts, he forecasts a slight growth of rental rates on the market: "Given the general macroeconomic parameters, inflow of capital to our country and inflation processes, the rental rates for office space may increase by 2-5% in 2011."

"The main bulk of demand on the market is generated by tenants migrating from Grade C and B business centers built in the early 2000s to more up-to-date office centers; yet new tenant companies are still scanty on the market," continues Ms. Kireeva. In her words, almost each urban business center has vacant areas in the form of small units at different floor levels. Nevertheless it is rather difficult for tenants to find an office above 1,000 sq m as a single block in one building. "During the next half year the level of vacant space in operational business centers will be going down on account of stably high demand and limited supply of new areas," she concludes.

Retail

In the opinion of more than 70% of respondents, demand on the part of retail space lessees was rising during the fall of 2010 and winter of 2011. Yet the forecasts for the nearest half year are not so optimistic: more than 50% of respondents expect the vacancy level and rental rates at shopping malls to remain at the previous level or rise insignificantly. "I believe we'll see stagnation on the market till the year's end and the fluctuation of prices won't exceed 5%. This prediction is based on the fact that refurbishment and expansion of sales areas are planned at many facilities; for all that, the tenant mix will remain almost unchanged and we'll hardly see new operators," affirms Ekaterina Lapina, director of commercial real estate department at ARIN.

The street retail market is better off, in expert opinion. The key retail routes (Nevsky, Vladimirsky and Zagorodny prospekts, Sadovaya Street, Bolshoi Avenue on the Petrograd side) are in high demand among public catering companies, pharmacies, toy shops, clothing and footwear, gifts and souvenirs, and others. In the words of Ms. Lapina, retail premises for lease at 32–34 Nevsky Avenue are now offered for $500/sqm/month (plus VAT). In March a small room at the same address was let at the price of $600/sqm/month. At other St. Petersburg retail routes the rent of areas for street retail starts from 3,000 rubles/sqm/month (less VAT and operating expenses). "The exposure time has markedly reduced – it takes one or two weeks to let spaces. For now an extensive database of attractive premises vacated by gambling businesses is available on the market, but in the near term these spaces will be sold out and the shortage of commercial areas will become inevitable. In view of this trend the rent prices for most liquid areas may increase by 25% till the year's end," she forecasts.

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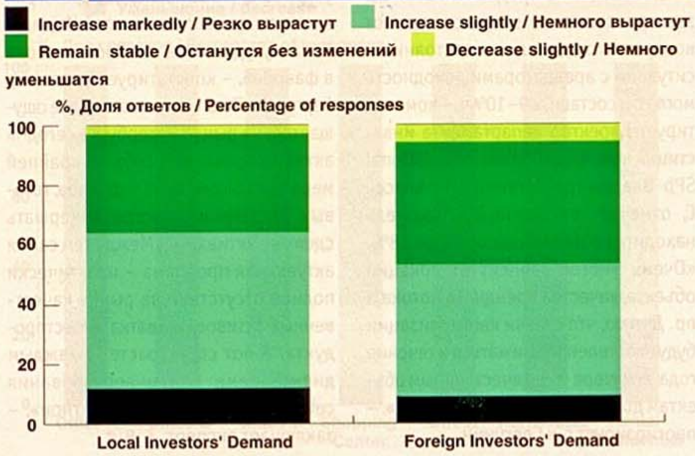

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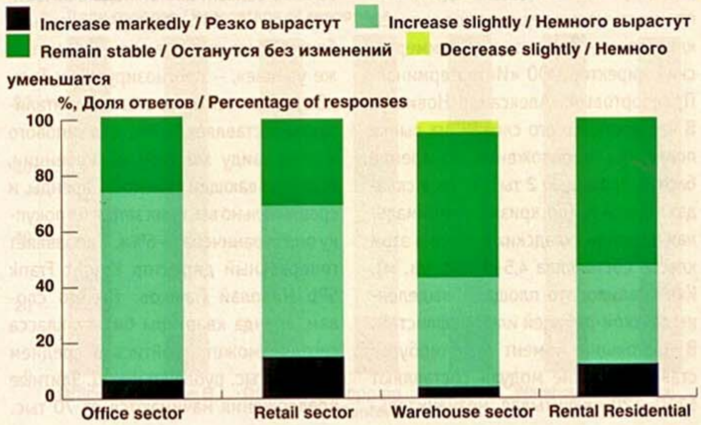

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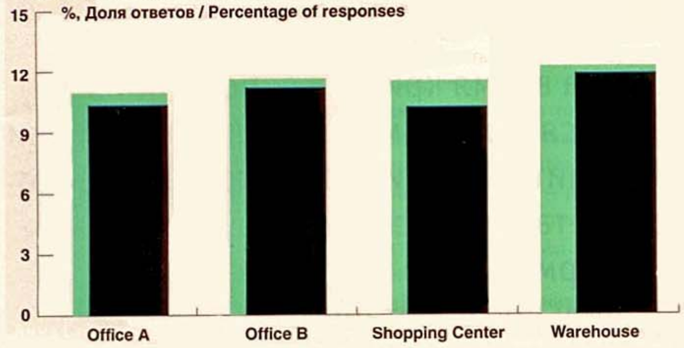

Warehouses

The industrial real estate market looks stable, whereas more than 50% of opinions indicate a slight increase in demand from tenants. "An economic downturn forced the warehousing real estate market players to look for new solutions to satisfy requests from the clients," states Alexander Novikov, commercial director of Interterminal-Predportovy. In particular he says 2,000-sqm units are now offered for lease in Class A warehouses (prior to the crisis the minimal offer in this class was 4,500–7,000 sq m blocks). These are normally spaces marked out by chain-wire or corrugated metal sheets. At the present moment the rates for such modules in St. Petersburg is in the range of $110–120. "Given an insignificant number of vacant areas in Class A warehouses and the fact that some of these facilities are not very favorably located from logistics perspectives, the rent growth to the level of $120-130/sqm/year for most liquid areas can be forecasted for the next half year," comments Mr. Novikov. In his opinion, the rental rates for top-class warehouses may rise most markedly in September-October of this year, since the activity of potential tenants traditionally increases in these months.

Housing

Most respondents think the rental rates in the housing sector will also get appreciated. In the words of Staffan Tast, regional manager of SATO Corporation in Saint Petersburg, vacant areas are dwindling and will keep dwindling in the company's portfolio during this year. "The rent of one-bedroom apartment between 60 and 80 sq m with modern-day finishes in a centrally located building currently costs from 60,000 to 80,000 rubles/month. The cap rates for investors in rental residential properties vary between 5% and 10%. They will likely remain at the same level during the next year," predicts Mr. Tast. "In the elite segment the cap rate is 5-7%. In view of tough competition limiting the cost of rent and relatively high purchase outlay, it is limited to 4-6% for standard housing," adds Nikolai Pashkov, CEO of Knight Frank SPb. In his words, the rent of a business-class apartment may cost 40,000-60,000 rubles/month. Luxury offers start from 70,000 rubles. "The rental rate is limited to 120,000-140,000 rubles/month, since it is already possible to select a decent two-bedroom apartment in this range," he states.

According to Mr. Pashkov, rental apartments in recently built houses bought several years ago for investment purposes have swelled the supply of late. "Because investors left the market at the beginning of the recession and most of the housing is purchased for habitation, we expect a slowdown of the supply growth rates. Now the share of investment deals is very low on the market; however it will be growing in the mid-term in view of market resurgence and the beginning of a new growth phase," the expert concludes.

Investments

Investment demand will most likely rise in other segments of the real estate market as well. "In the office real estate segment the yield of quality Grade B facilities is now at the level of 10–11% while Grade A facilities are not on sale. If they were, the yield could be around 9-10% depending on a specific building, its state and the situation with tenants," comments Vladimir Sergunin, investment director of Colliers International SPb. As for Grade C, the given parameter ranges from 12% to 18%, he notes. "Much depends on location, the quality of rental flows etc. I think the cap rates will be gradually going down during the next 12-18 months and drop to the level of 8.5-9.5% for quality facilities," Mr. Sergunin forecasts.

The expected reduction of cap rates during 2011 will amount to 50 basis points, in the opinion of most experts we polled. The reduction of this parameter by 0.7% in the segment of shopping centers looks slightly more attractive.

Office and retail real estate take the lead in terms of investment amount dynamics. Two thirds of the respondents expect an increase in the amount of acquisitions in these segments. As for the industrial and residential segments, most respondents forecast the amount of acquisitions will remain at the current level. About 50% of respondents expect a moderate growth of demand from foreign investors as well. "Demand for office real estate among domestic and foreign investors will be burgeoning. The time shows that real estate is a much more stable investment asset than the capital markets. As confidence in the future is gradually rising all over the world, the emerging markets with their higher risks and higher yields become popular again. And given that a number of economic parameters in India and China have deteriorated, investors may hold a more favorable attitude to Russia again," states Mr. Sergunin. In his opinion, this can already be sensed: at least 10-15 companies and funds ready to complete fast transactions with assets are now active in St. Petersburg market. "Meanwhile the most relevant problem is almost a complete lack of quality assets – the dearth of investment products. And demand keeps growing every day: now is the most favorable time for investments," the expert concludes. C|R|E