on *point*

Jones Lang LaSalle®

Russia Shopping Centre Market Report March 2007

Russia …

World's *largest* landmass

80% of population (114 million) live in the European part of Russia

Source: Jones Lang LaSalle Research

Cities with population > 4m

Moscow	10,400
St Petersburg	4,600

Cities with population ≥ 1m

Novosibirsk	1,413
Nizhny Novgorod	1,297
Yekaterinburg	1,287
Samara	1,144
Omsk	1,122
Kazan	1,107
Chelyabinsk	1,071
Rostov-on-Don	1,062
Ufa	1,041
Volgograd	999*
Perm	989*

*as of January 1, 2005

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Summary

Investment market

With the first shopping centre investments of Western institutional investors having taken place, a shopping centre investment market is becoming established. It is forecast to grow substantially as the development pipeline comes on stream. Jones Lang LaSalle forecasts that Russia will be the third largest retail investment market in Europe in 2007, behind the UK and Germany.

Financing

European lending institutions have recently entered the market. They will have a positive affect on the Russian real estate investment market as they are prepared to lend at significantly more competitive terms than Russian banks.

Rental levels

Although rental levels in Russia are higher than in many European markets, employment and utility costs are much lower than in Western Europe and therefore Russian retailers can afford to pay proportionally more on rent without compromising profitability.

Rental growth

Rental growth is expected to continue in Moscow and St Petersburg for modern, high-quality shopping centres and prime high street locations. In the regions, where shopping centres are undersupplied, rents are also expected to grow but the rate and level of growth will vary significantly by location and asset.

Shopping centre stock

Russia is very undersupplied in terms of shopping centre floor space, with a total of just 3.6 million m^2. This translates into 149 m^2 of shopping centre space per 1000 inhabitants in Moscow and as low as 20 m^2/1000 inhabitants in a regional city like Novosibirsk.

Supply

Russia has the largest shopping centre pipeline in Europe. In general, the projects in the pipeline will be high-quality, modern shopping centres with sophisticated design concepts and tenant mix. Most international developers represented in the Moscow retail market are now actively expanding into the regions including IKEA (Sweden), Metro (Germany) and Ramenka (Turkey).

Population

The Russian Federation occupies the world's largest land area and has a population of 142.3 million. There are 13 cities in Russia with a population of over one million and an additional 35 cities with a population over 500,000.

GDP/FDI

Russia has experienced significant economic growth since 1999, with real GDP growing by an average of 6.8% per annum. In 2006 Foreign Direct Investment (FDI) increased by 133%, reaching an estimated US$35bn, a ten-fold increase over the level in 2002.

Consumer spending

The potential for the Russian retail market is enormous and is supported by Government measures aimed at growing disposable income and stimulating consumer demand.

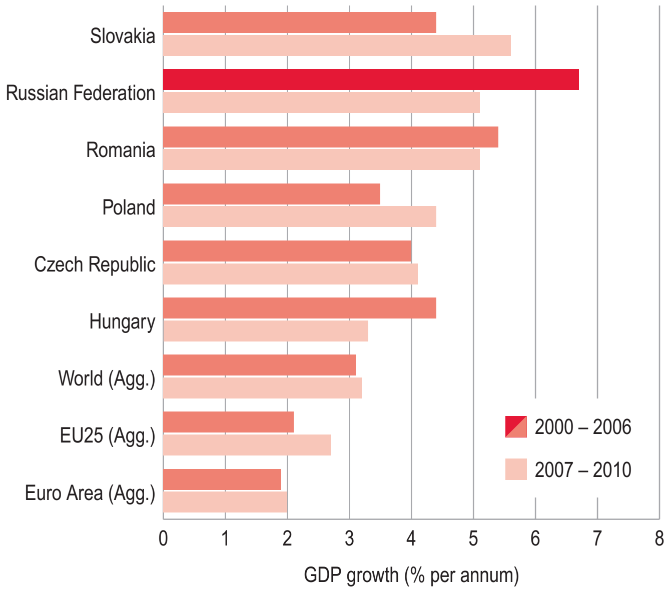
Retail sales

Retail sales grew by 18.5% from 2005 to 2006 and are estimated to total over US$185bn at the end of 2006.

Economic outlook & business climate

GDP Growth across Europe

Source: EIU



One mega city and 12 cities of over one million people

The Russian Federation occupies the world's largest land area and stretches from the Baltic Sea to the Pacific Ocean across 11 time zones. The country has a population of 142.3 million (73% urban), the majority living in the European part of Russia (west of the Ural Mountains). There are 13 cities in Russia with a population of over 1 million and an additional 35 cities with a population of over 500,000.

The Greater Moscow area, which includes the capital city with a population of 10.4 million and adjacent towns, comprises more than 15 million people and is the economic and political centre of the Russian Federation. St Petersburg is the second largest city in Russia with a metropolitan population of more than 5.3 million. Regional cities with a population of over one million people are known as the 'Millionniki' and include: Kazan, Yekaterinburg, Rostov-on-Don, Nizhniy Novgorod, Samara, Volgograd, Novosibirsk, Perm, Ufa, Omsk and Chelyabinsk.

Russia's huge population, vast land area and regional differences help to support a booming economy with an increasingly stable government. The pace of change in Russia now represents a major opportunity to retailers, shopping centre developers and investors.

Strongest economic growth in Europe

Russia's economy has been growing strongly since 1999 – by an average of 6.8% per annum. This level of growth is expected to be maintained through 2007. Thereafter, GDP growth is forecast to remain above 5% until early 2009, which is still far ahead of the Eurozone and most other CEE economies.

Whilst Russia's economic growth has been significantly bolstered by high prices for oil and gas (Russia's chief exports), the Government's prudent fiscal management and pro-market structural reforms have played an important role as well. Record-setting revenues from energy exports have allowed the Government to amass significant funds, and the country's currency reserves reached an all-time high of US$303bn as of 1 January 2007. However, recognizing that the economy is sensitive to oil price swings, and further proving its commitment to long-term sustainability, the Government has set up a stabilisation fund to allocate budget surpluses in times of high oil prices. This fund is expected to reach US$100bn by the end of 2007.

Economic fundamentals are positive

Positive changes in the Russian economy, accompanied by the growing confidence of international investors, have allowed the Government to pay as much as US$30bn of its foreign debt to the IMF and the Paris Club ahead of time, significantly improving the country's debt rating. Since 2003, the international rating agencies have all subsequently upgraded Russia to investment grade, reflecting the country's growing financial stability.

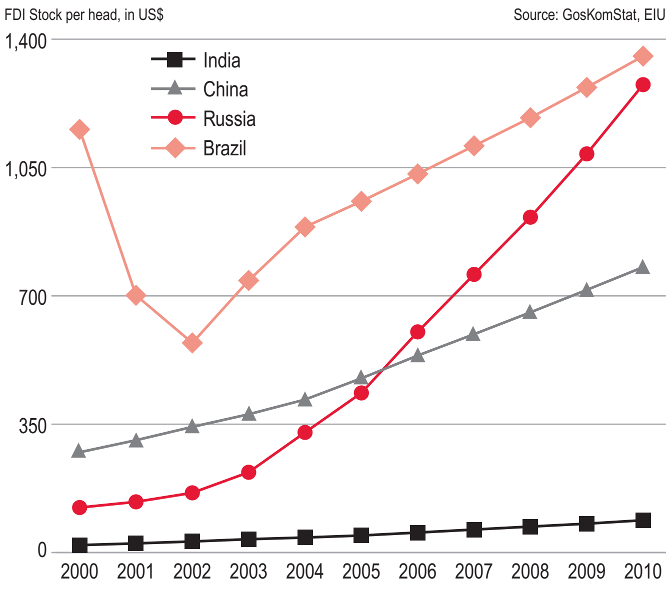
		Moody's	Fitch	S&P
Russia	2006		BBB+	BBB+
	2005	Baa2	BBB	BBB
	2005			BBB–
	2004		BBB–	BB+
	2003	Baa3		
	2002	Ba2		
Moscow	2006	Baa1	BBB+	BBB+
	2005	Baa2	BBB	BBB
	2005			BBB–
	2004	Baa3	BBB–	BB+

As a result of continued stabilisation and as the Government takes steps towards improving the business environment, foreign investors are becoming more confident about Russia. In 2006 Foreign Direct Investment increased by 133%, reaching an estimated US$35bn, a ten-fold increase over 2002. Investment is also becoming more diversified and is not concentrated solely in the oil and gas sector.

Russia is expected to join the World Trade Organization in 2007, opening up new opportunities for foreign investment, which should benefit the Millionniki cities in particular. Much has already been accomplished by the Russian Government in terms of reforms to the business environment, including the adoption of a new legislation package aimed at reducing tariff rates, simplifying the existing tariff structures and reducing the tax burden on businesses.

After the 1998 devaluation, the rouble continued to depreciate until 2002. Since then, the rouble has experienced real appreciation of 14%. The Russian Central Bank (RCB) is moving away from targeting the rouble against only the US dollar and has shifted some of the weighting to the Euro. Inflation is falling, and is forecast to be circa 7% by 2010.

FDI Stock in BRIC Countries



Political stability

In general, the political climate in Russia is now viewed as stable. The reforms initiated by President Putin have resulted in a reduction of tension between the Federal Government and Regional Authorities, largely due to a revised and improved system of sharing fiscal power between the federal centre and the regional authorities. The next Presidential election in March 2008 will see the end of Putin's term in office. Analysts and observers suggest Putin's successor will stay the course and retain the positive trajectory of political reform and a stable investment climate.

In summary, the Russian economic recovery is expected to be sustained over the medium to long term, characterised by real GDP growth of circa 5% per annum on average, declining inflation, budget surplus, a declining current account surplus, rising foreign exchange reserves and falling external debt.

Substantial growth in Moscow, St Petersburg and the Regions

Moscow has one of the fastest rates of economic growth in Europe, at approximately 6% per annum between 2005 and 2009.

Moscow residents have the highest and quickest growing average income in the country, which has nearly doubled since 2002. At nearly US$13,400 income per capita (2006 Jones Lang LaSalle estimate), the city is an attractive place for retail development.

St Petersburg has experienced a significant economic upturn in recent years and is the only major urban centre in the north west part of Russia.

In terms of population, St Petersburg is roughly three times larger than the CEE capitals of Warsaw, Prague and Budapest, which is why – with growing income levels – the city has extensive market potential.

In 2005 average reported disposable income per capita in St Petersburg reached US$4,700 and is expected to grow significantly over the next 3-5 years.

Regional cities over 1 million report annual income per capita between US$3,000 and US$4,500.

Consumers across the regions spend between 64% and 89% of their income on retail expenditure, providing lucrative markets for retailers.

With a shopping centre stock per 1000 inhabitants as low as 20 m^2 in some regional cities, the growth potential for development and investment over the medium term is very significant.

Retail market in *Russia*

12th largest retail market in the world

The retail market was one of the first industries to be privatised in Russia and has also been one of the key sectors for new business development, due to the relative ease of entry. Nevertheless, the domestic retail market has been somewhat slow to mature and Russian consumers have relied heavily on imported goods. During the 1990s and early 2000s, imports accounted for over 50% of the consumer market.

According to Euromonitor International, total retail sales in Russia reached US$156bn in 2005 and the estimated figure for 2006 is US$185bn. This is a real growth rate of 11.5%. A similar growth rate is forecast in 2007 and will deliver total retail sales of circa US$216.9bn.

The Economist Intelligence Unit (EIU) ranks Russia as the 12th largest retail market in the world and the 6th largest across Europe, only marginally behind major Western European countries.

Growing disposable income will drive future growth

The potential for the Russian retail market is vast, and is supported by Government measures aimed at growing disposable income and stimulating consumer demand. Since 2004 reforms include:

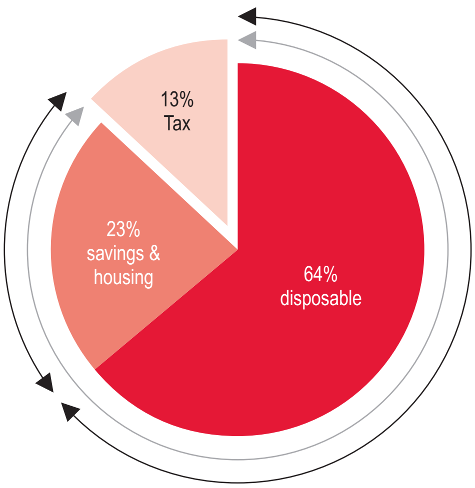
- Increase in minimum wage from 800 roubles in September 2005 to 1100 roubles in May 2006.
- Reduction of VAT from 20% to 18%.
- Abolition of the 5% sales tax.
- Introduction of a flat tax rate on personal income of 13% from a tiered system of 12%, 20% and 30%.

The impact of such reforms is clear, as real personal disposable income has increased by an average of 10.7% per annum from 2002-2006. This trend is set to continue in 2007-2010.

Russian consumers are also able to spend a larger portion of their income than their European counterparts. This is due in part to the continued existence of housing and utilities subsidies, but also to the general strengthening of the economy and relatively low personal income tax.

Disposable Income Estimates – Average Muscovite

(9.5 million people with a mean wage US$10,000)

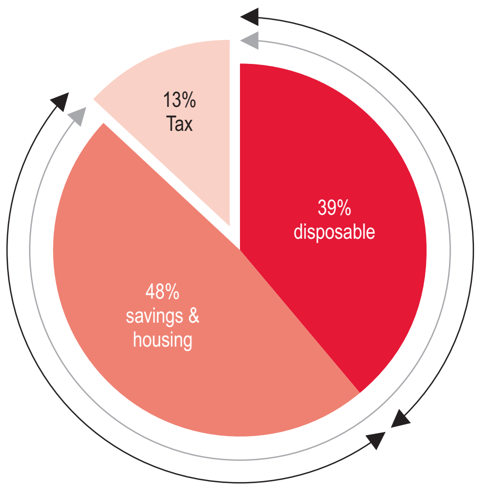


Take home 87% of income

Source: Jones Lang LaSalle estimates

Disposable Income Estimates – Middle Class

(1 million people earning >US$100,000)



Take home 87% of income

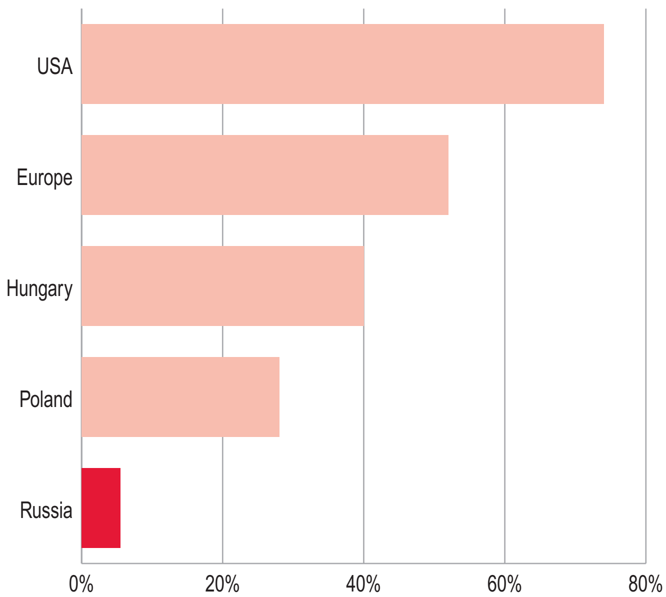
Source: Jones Lang LaSalle estimates

...as will the growth in consumer credit

Consumption is expected to remain high in Russia, especially as incomes rise and consumer credit becomes more available. Consumer credit only originated in 2002 and is rapidly growing. In Moscow per capita consumer debt is expected to grow seven-fold by 2010.

Strong retail sales growth in Russia is forecast over the medium term. In the period from 2007-2010, retail sales are forecast to grow by average of 6.7% per annum. This compares with circa 2.5% average growth in the Czech Republic, 1.6% in Hungary and 1.5% in Western Europe.

Personal Loans 2005 (% of GDP)



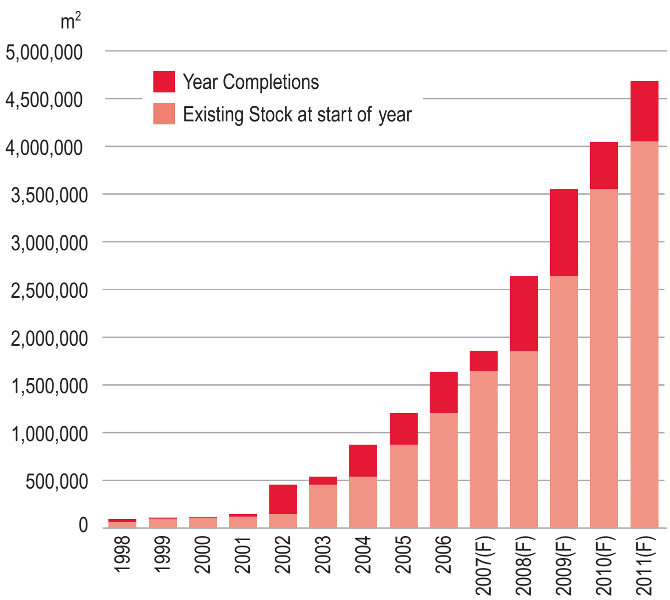
Retail provision

Although the Russian retail market is vast in terms of total sales, on a supply per capita basis it is apparent that many consumers, particularly those in less developed areas outside of Moscow or St Petersburg, are underserved.

The retail market is still immature. Modern retail does exist in the form of shopping centres, supermarkets, hypermarkets, convenience and discount stores, but these only account for 25% of total retail sales in Russia and 45% in Moscow (Business Analytica and Deutsche Bank Research estimates).The remaining portion is captured by outdoor markets. However, this is changing. For example, Local Authorities in Moscow have closed 125 outdoor markets in 2005-2006, leaving just 115. Another 45 markets are expected to close by 2010, mainly in the central part of Moscow.

This trend is also evident in the Millionniki cities, where local governments have started to close or reconstruct open markets with the assistance of local developers.

Existing Shopping Centre Stock and Completions Dynamics



The shopping centre development market is booming

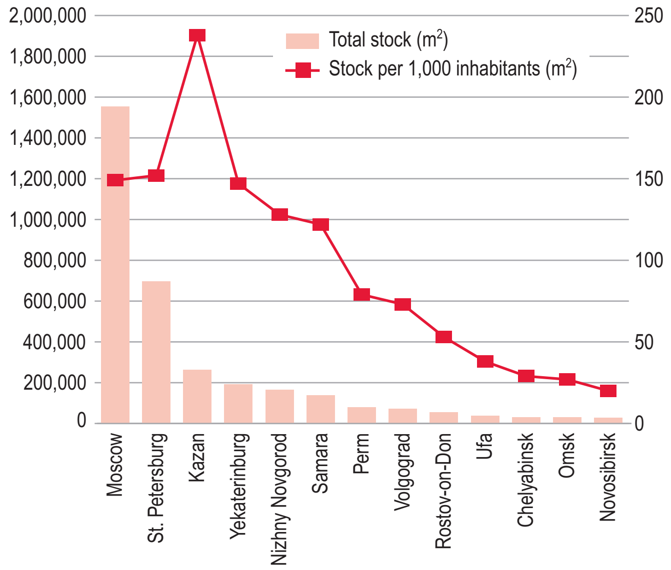
In 2002 there were very few high-quality shopping centres in Moscow and even fewer in the Regions, but since then growth has been dynamic and by 2006 modern shopping centre stock in Russia totalled approximately 3.6 million m².

Moscow accounts for 43% of total stock (over 1.5 million m²) in 52 modern, high-quality shopping centres, seven of which were completed in H2 2006. Until recently, Moscow was by far the main focus of shopping centre development and international retailer expansion but developers and retailers are now also targeting the Regions. For example, in 2006 IKEA developed four further malls under their Mega Mall brand: one in Yekaterinburg (90,000 m²); another in Nizhniy Novgorod (98,600 m²); and two in St Petersburg (135,000 m² and 100,000 m²).

…but has a long way to go to match West European levels

In spite of substantial development in recent years, Russia is still very much an undersupplied market. By total stock and especially by stock per capita, Russia (23m²/1,000 pop.) ranks well below the European average (176m²/1,000 pop.).

Shopping Centre Supply: Total Stock and Stock per 1000 Inhabitants 2006



Over the medium term, Russia has the largest shopping centre pipeline across Europe with new generation high-quality shopping centres making up an increasing proportion of the total stock.

Expanding retailers will choose shopping centres over high streets

High street retail has been a less significant force in the Russian retail market, with only a handful of prominent high streets serving Moscow, a city of more than 10 million people. While these areas are still important, they are becoming more integrated into mixed-use developments, often located at the ground level and underground floors of residential and office buildings, usually coupled with cafes and restaurants. The high street retailers tend to be positioned more towards high-end luxury and consumer goods sectors.

In general however, the harsh winter climate in Russia means that shopping centres are the preferred destination for both retailers and consumers. With the growth of the shopping centre market and lack of well-configured high street space, further retail expansion is expected to be absorbed almost entirely by shopping centres.

Retail warehousing is just emerging as a concept

Currently the retail warehousing sector is still very much in its infancy and there is very little existing product. The market is currently dominated by owner occupiers, both domestic (e.g. Perekrostok, Lenta, O'Key) and international occupiers (Metro, Auchan, Leroy Merlin, Castorama, Decathlon, OBI) and there are now several projects under construction in Moscow and St Petersburg. This segment of the retail market is due to expand rapidly.

Key retail facts by city

Moscow

- Largest market in Russia.
- Emerging, Western-style middle class, comprising 30% of the city's population.
- Disposable income per capita has more than doubled since 2000.
- Cost of housing is negligible.

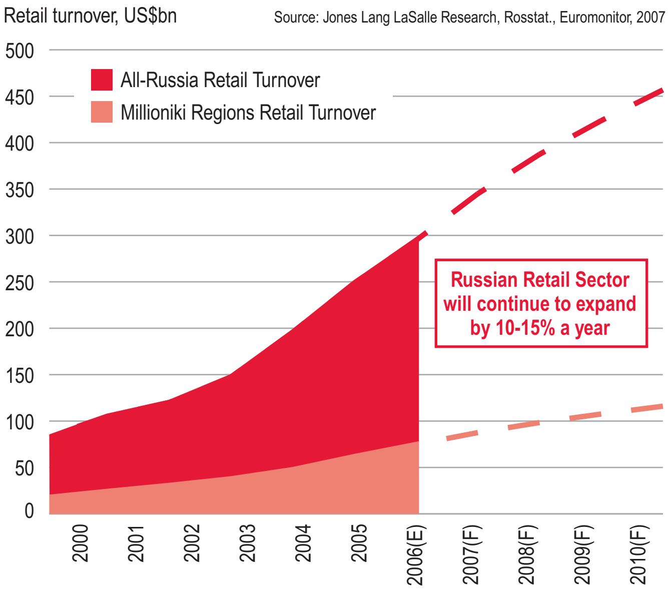
St Petersburg

- Higher than average income levels (US$4,700).
- Local retailers are considered very strong.
- Very large pipeline of quality retail properties.
- New generation shopping centres are drawing in international retailers.
- In 2006 examples of new generation shopping centres included MEGA Kudrovo, MEGA Parnas, Grand Kanyon and Piter-Raduga. All are well designed and have a strong tenant mix.

Regional

- Shopping centre concepts with large entertainment components dominate the pipeline.
- Increases in personal disposable income, coupled with a growing but undersupplied retail offer are expected to give regional markets a competitive edge over the short to medium term.
- Income levels vary substantially from city to city.
- Economic growth led by the energy sector has contributed to rapid development in many cities. Tyumen, a city of approximately 500,000 people, is estimated to have income levels and standards of living just below that of Moscow.
- The regional markets offer freehold land tenure and an increasing emphasis on investment incentives from local government and, as such, regional retail markets are expected to be some of the fastest-growing in Europe. As investment grade shopping centre space is delivered to the market, capitalisation rates are expected to quickly converge with those of Moscow and St Petersburg.

Growth of Russian Retailing



Major developers

Moscow

The first international developer to enter the Moscow market was Ramenka (a joint venture between Migros and Enka) from Turkey. It started developing a supermarket chain and then built the first Ramstore shopping centre in 1997. Today Ramenka operates nine shopping centres and has built 28 supermarkets with a total area of 83,000 m^2 – 22 of them in Moscow and the Moscow region and six of them in the cities of Krasnoyarsk, Kazan, Nizhny Novgorod, Rostov, St Petersburg and Samara. The largest Ramenka project is Ramstore Capitoliy on Vernadskogo Prospect, which is a 130,000 m^2 development that includes a Karo cinema, bowling centre and underground parking with 1,500 spaces.

The Swedish retailer/developer IKEA has also been a key player in the Russian market. IKEA first entered Moscow in 2000 with a 31,000 m^2 furniture store and quickly moved to the development of their Mega Mall schemes. MEGA 1 opened in 2002 with a total of 185,000 m^2 and includes both strong international and domestic retailers. MEGA 2 was subsequently opened in 2004 with a total of 135,000 m^2. In Q4 2006 MEGA Belaya Dacha was opened, adding a further 105,000 m^2 to Moscow's modern shopping centre stock.

Auchan is another strong international developer that operates nine hypermarkets in Moscow. They have entered the market both by being anchor tenants in schemes such as MEGA 1 & 2 and the L-153 shopping centre, and by developing their own hypermarket-anchored schemes. In 2004/2006 Auchan introduced partners Leroy Merlin (DIY) and Decathlon (sport) to the Russian market.

Domestic developers have also been active in the Moscow retail market. There are several companies that are actively working in this segment, including Sistema Gals, Daev Plaza (developed Evropark; and two other centres in the planning stage); STT Group (developed the first two Real projects in Moscow); and Garant Invest.

St Petersburg and Regional development

Most international developers present in Moscow are now actively expanding into the Regions. Many developers regard St Petersburg and the Regions as a priority as there is a severe lack of modern retail space, presenting substantial development opportunities.

IKEA already has stores in St Petersburg, Kazan and Yekaterinburg, and is in the process of acquiring sites in other large cities. They are developing MEGA shopping centres in Novosibirsk (due to open 2007), Samara (2007), Rostov-on-Don (2007), Ufa (2007), Volgograd (2008), Omsk (2009) and Perm (2009).

Ramenka entered the Regional market in 1999 and remains an active developer. They now operate several shopping centres and a large network of stand-alone supermarkets in 14 cities apart from Moscow, and plan to enter another 14 cities including Novosibirsk, Sochi, Tol'yatti, Tomsk, and Krasnodar.

However, most shopping centres in the Regions have so far been developed by domestic operators. The largest of these is the Vremya Group (operating under the 'Park House' brand) and Rosevro Development. In the Millionniki, the Vremya Group has four existing shopping centres and six under construction or in the planning stage.

Rental markets

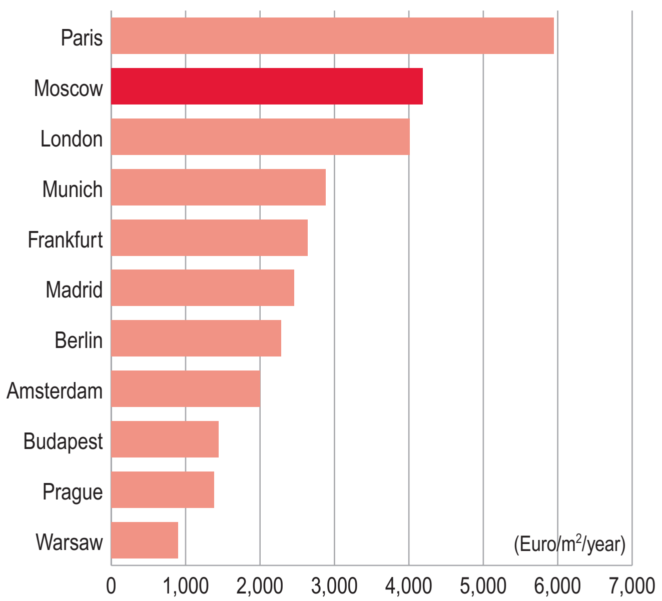
Rents and sales densities

A Pan European comparison

Retail rents across Russia have been driven by supply constraints and have experienced significant growth since 2000. As a result, the prime annual base rents in Russia are among the highest when compared to other major European countries.

The availability of large-scale units has been even more constrained in Russia and, as a result, the majority of retailer demand has been focused on smaller units and this has forced up rents on small units in both shopping centre and high street locations.

High Street Prime Rents, Q4 2006



Rental levels across Russia

Rental values vary extensively across the Russian retail market, the result of location, use, unit size and achievable turnover. As in most typical retail markets, high street and city centre locations in Russia tend to achieve the highest rents, mostly due to strong retailer demand for prime locations. Rents on Moscow's Tverskaya Street are comparable to prime high street rents in London.

Typical **Moscow Shopping Centre** rents are as follows:

Hypermarket (>5,000 m^2)	US\$100-250/m^2/year
Entertainment (>2,000 m^2)	US\$150-250/m^2/year
Retail Gallery	US\$800-5000/m^2/year
White & Brown	US\$250-400/m^2/year
Sport	US\$200-400/m^2/year

Typical **Regional and St Petersburg Shopping Centre** rents are:

Anchor and Mini-Anchor (>1,000 m^2)	US\$100-400/m^2/year
Entertainment (>2,000 m^2)	US\$100-200/m^2/year
Retail Gallery	US\$400-2500/m^2/year
Food-court	US\$300-500/m^2/year

Are rental levels sustainable?

Rental levels in Moscow are relatively high, but not compared with the other mega cities in Europe.

Although rents can be high in some locations, other occupancy costs such as employment and utilities are much lower than in Western Europe. Therefore, Russian retailers can afford to pay proportionally more on rent.

The key differential is the low cost of labour for a relatively high quality workforce. On a per hour basis, 2006 labour costs in Russia were about US\$2/hour compared to over US\$34/hour in Germany.

In addition, recent tax reforms have significantly eased the tax burden on corporations and small businesses. This includes the reduction of the corporate profit tax rate from 35% to 24% and an increase in the availability of deductions for regular business expenses.

Retailer turnover is the most important component of sustainability of rents. Rent to sales ratios (RSRs) provide a useful tool in measuring the ability of retailers to pay rent by assessing the amount of total sales they generate in comparison to their rent. In Moscow rents are relatively high but due to the lower operating costs that tenants face in the Russian market, we believe that RSRs in the range of 15-20% are sustainable. This is considerably higher than in Eurozone countries where RSRs are typically in the 4-8.5% range.

It is also important to note that retailer turnover levels in Russia can be very high, particularly for branded goods. The rapid growth in consumer credit will be a key factor in sustaining retailer turnover levels in coming years.

Prospects for rental growth

As supply constraints ease over the long term, average rental growth is expected to stabilise and soften. As new shopping centres are built, older 'less prime' centres that do not refurbish/upgrade their offer are likely to face a softening in rental levels over the medium term. In contrast, rental levels in modern, high-quality shopping centres and prime high street locations are expected to increase as a growing number of international and domestic retailers compete for the best space.

The regional retail markets are highly diversified and while rental growth is expected across all regions, the rate and level of growth will vary significantly depending on the local market.

The significant undersupply of modern retail space in the regions combined with strong income growth and rising consumer demand is expected to drive rental growth over the short to medium term.

Standard shopping centre lease structure for modern, high-quality shopping centres

- Leases are normally 10-20 years for anchors, 5-10 years for mid-size units and 3-7 years for small units.
- Rents are generally index-linked on an annual basis – denomination is set to US$/m² although payable in roubles. More recently we are seeing rents denominated in Euros. Payment terms are quarterly in advance.
- Turnover rents are becoming more common, although mainly limited to well-established retail chains. Percentages range from 2-20% depending on retailer type (for example: supermarkets – 2%, restaurants – 20%).
- Standard leases include a one to three-month deposit.
- Standard leases also include a one to three-year prepayment of rent. The deposit is offset against the last rent payment. For larger tenants, it is typical for a bank guarantee to be used.
- Developers are normally responsible for full fit-out of the common areas and tenants are responsible for internal fit-out.
- Currently tenants pay a fixed service rent in Moscow in the region of US$120-150/m²/year.
- As in many emerging markets, there remains inconsistency in the format of leases. In particular, many older shopping centres do not contain provisions for turnover rent, indexation and service charges.

Major retailers

The vast land area and the underdeveloped nature of the retail market means that no retailer has so far managed to dominate the market.

Domestic players

Although international retailers have been quite successful in Russia in recent years, domestic retailers still account for 6 out of the 10 top retailers by total sales.

In response to competition from international retailers, some domestic retailers have started to expand more rapidly and to adapt their store formats to European standards. Retailers that have been particularly expansive throughout other regions include Pyaterochka (food retailer, present in almost all cities with a population over 500,000); Eldorado (electrical retailer, largest in Russia by total sales, covering all cities with population over 1 million and some smaller cities); Perekrestok (food retailer, operating 113 stores in Moscow, St Petersburg and the Regions), and M.Video (electrical retailer, located in all Millionniki cities).

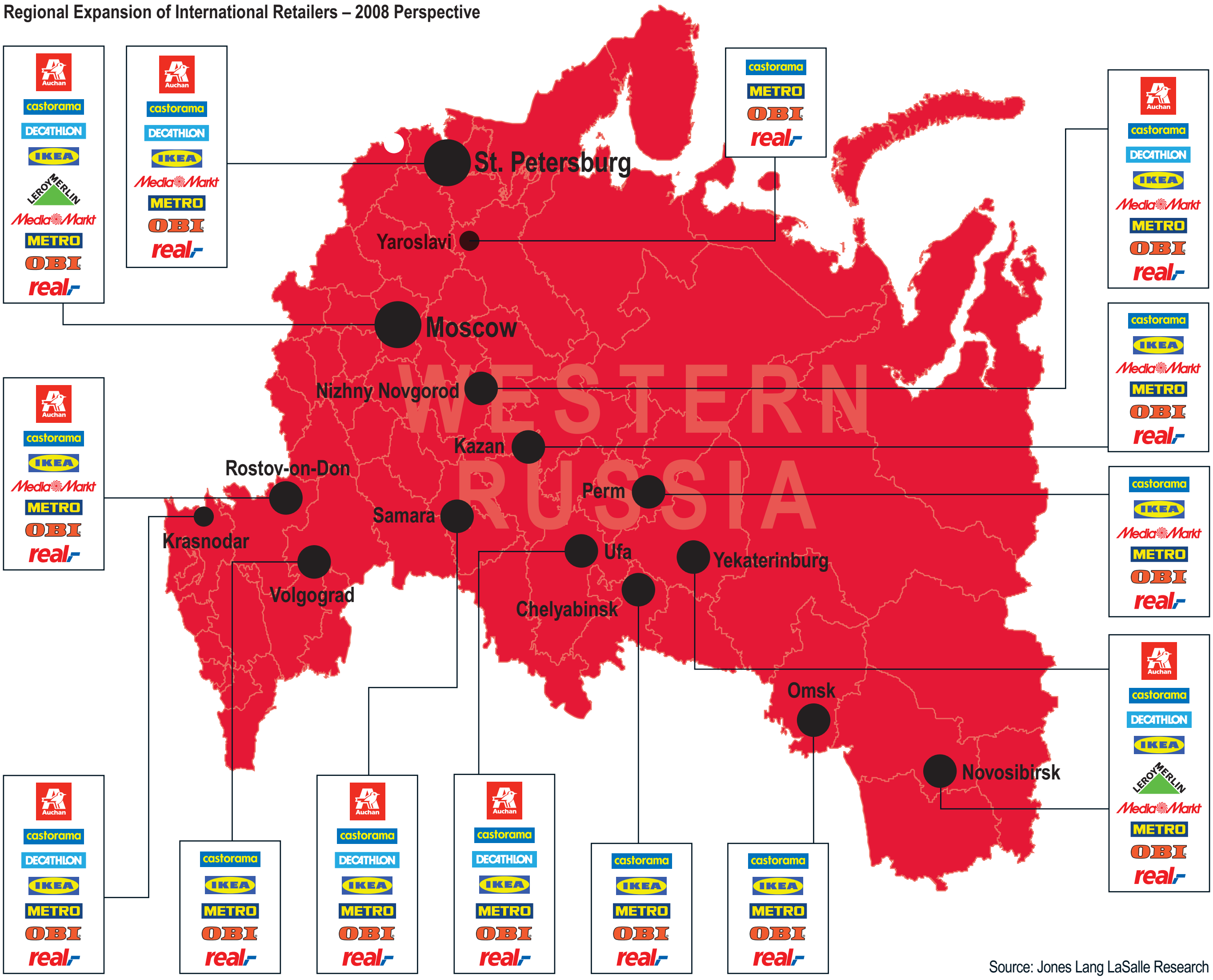
Regional expansion by international retailers will pick up in the medium term. Retailers that have been particularly active in the regions include IKEA; Metro Cash & Carry (three stores in St Petersburg, and one each in Yekaterinburg, Nizhniy Novgorod, Samara, Kazan, Rostov-on-Don, Ufa, Volgograd and Perm); and Ramstore, operating in 14 cities.

Key recent entrants to the Moscow market include Media Markt, British fashion chain Top Shop and the Inditex Group with their Bershka, Massimo Dutti, and Pull and Bear brands.

International players

Several international retailers working in the large-format segment are present in the Moscow retail market. There are more than 100 foreign brands operating in Moscow, but only a few of them are represented directly, for example Real, Auchan, IKEA, Metro, Leroy Merlin and OBI. The majority of international brands such as Intersport, Mango, and Mexx are working under franchise agreements.

Regional Expansion of International Retailers – 2008 Perspective



Source: Jones Lang LaSalle Research

Investment market

Retail investment in Russia

The prospects for the retail investment market in Russia are extremely positive. Russia has the largest development pipeline in Europe with new schemes planned throughout the country. In time, the Russian market will provide investors with a full range of shopping centre investment opportunities, from hypermarket-anchored schemes to fully-integrated leisure and shopping centre projects.

The quality of new development is high. Russian shopping centres such as Atrium, the Mega Malls, Festival and Metropolis (2008) now match the best examples found in Western markets in terms of design and standards of construction. Both domestic and international retailers see huge potential in the Russian markets as domestic retailers become more sophisticated, with some now boasting annual turnovers far in excess of better-known Western brands.

Over the last two years prime shopping centre yields in Russia have witnessed significant compression.

In Moscow prime yields have hardened by more than 200 basis points making it one of the most rapidly maturing markets in Europe. Jones Lang LaSalle views the next 12-24 months as a period of continued yield compression, with prime yields in Moscow expected to harden significantly. The Regional market will also see yield compression with prime yields already as low as 10%, showing convergence with the Moscow market.

Prime European Shopping Centre Yields, Q4 2006

	Yield
Moscow	9.50%
Prague	5.75%
Budapest	5.75%
Warsaw	5.75%
Frankfurt	5.00%
Stockholm	5.00%
Milan	4.75%
Brussels	4.75%
Madrid	4.75%
London	4.75%
Paris	4.50%
Amsterdam	4.50%

The Regional investment market is proving to be increasingly attractive to international and domestic investors alike. While exposed to less competition and similarly positive trends in yield compression, a decisive feature of Russia's Regional markets (in comparison to Moscow) is the strong influence of freehold tenure on development decisions, allowing investors a familiar and more secure title over their investment.

Moreover, international retailers can now be found in all of the cities with populations over one million and most with over 500,000, fueling investors' future expectations.

As in Central Europe, investors will need to focus their attention on the long-term prospects of their retail acquisitions, specifically looking at the qualities which enable a shopping centre to dominate its catchment area in the future. Scale will be important but equal attention must be paid to achieving a balanced tenant mix which is best suited to the catchment area. The key to acquiring shopping centres in Russia will be a keen eye on sustainability.

Seizing these opportunities will be a wave of both domestic and international capital which, combined with a healthy pipeline of high-quality new stock and rising consumer expenditure, is yielding one of the fastest, most promising investment markets in Europe. This is being underpinned by the increasing strength of both Russian and international retailers in the market and greater access to cheaper sources of debt from Western lenders.

International banks are actively lending to the real estate sector

European lending institutions have recently entered the market. They will have a positive affect on the Moscow real estate investment market as they are prepared to lend at significantly more competitive terms than Russian banks. Foreign banks actively lending in the real estate sector in the Russian Federation include: Aareal, Hypo Real Estate, Eurohypo, Erste Bank, Raiffeisen, Société Générale, Bank Austria Creditanstalt and certain merchant banks.

Senior debt for refinancing is available in the Russian Federation through Russian as well as Western banks. The latter provide the most attractive terms and the majority of senior lending has been done by the large German and Austrian mortgage banks. The senior debt financing available in the market can be structured to meet a variety of buyers' needs. Typical terms may include: 70% to 80% LTV, 275 to 350 basis points over US$ LIBOR, 15 to 20 years amortization and a 5 to 10-year term.

Project finance is available in Russia mostly through state-controlled giants, Sberbank and Vneshtorgbank. The largest Russian private banks such as Alfabank may also provide project finance. Typical terms for US$ nominated loans are 10-14% interest rate, loan term 1-3 years and the principal paid in full upon debt maturity. Western banks (EBRD, IFC, Hypo Real Estate) have started to consider project financing opportunities in Russia as well, although currently their activity is limited. They may lend for up to five years at a LIBOR + 400-500 basis points. When providing project finance these banks are likely to seek the opportunity to refinance the project after construction completion.

Legal environment

The Land Code

One of the key deterrents to entering the Russian property market faced by international investors, retailers and developers alike is the market practice of holding land plots through 49-year leasehold agreements rather than freehold agreements. However, the Russian Government has recognized this as a major issue and has made significant improvements in order to bring the Russian property market more in line with international standards.

In October 2001, the new Land Code was adopted as a Federal Law, allowing full land ownership rights of non-agricultural land in the Russian Federation to foreigners (with certain restrictions applying to agricultural land and land in special territories). The new Land Code represents an important step in the development of the Russian property market and encourages international investment by granting foreign individuals/legal entities essentially the same rights as Russian individuals/legal entities. This is being accepted and applied by most regional authorities.

In Moscow, it is expected that actual implementation of these procedures may take longer to adopt because the position of the Moscow Authorities has generally been opposed to ownership of land. However, the Federal Law and Land Code take precedence over local authorities' regulations, and it is anticipated that the Moscow Government will make necessary changes in line with the Federal legislation within the next 5-7 years.

It is expected that existing 49-year leases will remain as such throughout the duration of the contract. The lessee has a pre-emptive right to extend the leasehold agreement and it is anticipated that most lessees will also have the ability to convert to a freehold, although the exact mechanism for doing so has not yet been established.

Land titles come into effect after registration in the State Register of Rights in Immovable Property. No State Registration is required for lease or sub-lease agreements concluded for a period of less than one year, if otherwise not specified.

Tax considerations

In Russia property can be transferred either through direct asset or company/share deals. Whilst company/share deals are generally more tax efficient and more common in Russia, there can be more risk associated with these types of structures. Taxes relating to property transactions include the following:

- VAT: applies when property is transferred through a direct asset deal, but not when transferred through a company/share deal. Tax is 18%, levied against the value of the property and is only refundable over several years.
- Companies' Property Tax: applies to property recorded on the balance sheet as a fixed asset. The official tax rate is set by regional authorities (not to exceed 2.2%) and is based on the average annual balance sheet value with appropriate deductions made for depreciation.
- Companies' Profits Tax: applies to any incremental value gained by the sale of property, taxed at 24%.

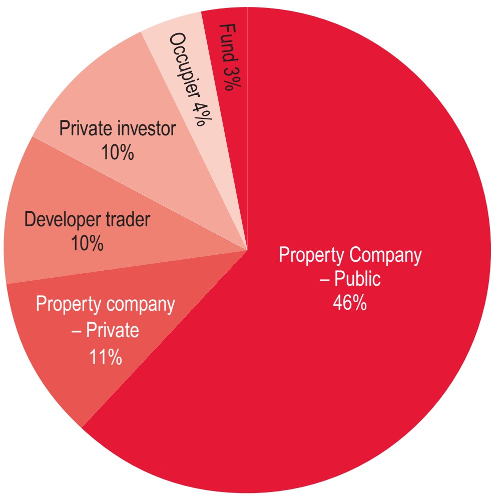
Given the complexities of the tax system in Russia, it is no surprise that the major tax advisors are already present in Moscow.

2006 was a benchmark year for retail investment in Russia

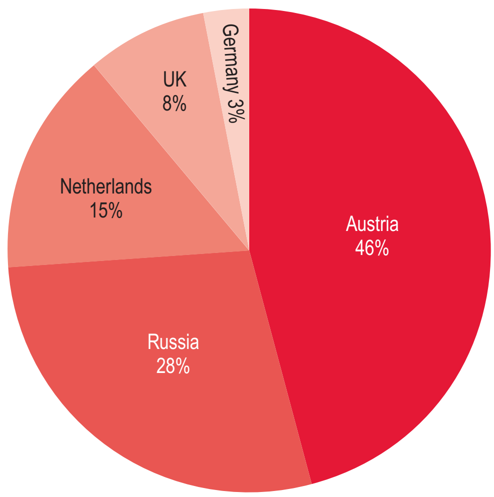
Over 20 modern-style shopping centres were traded in 2006 at a total capital value of circa US$1.5 billion. However, this is a figure Jones Lang LaSalle believes actually understates the true amount of transactions, as many still occur off-market. Compared to 2004/2005 when only two and three modern centres were traded respectively, this material increase highlights a quickly growing market and underlines investor confidence in Russia and the Real Estate sector.

Across Europe cross-border investment volumes have grown significantly over the previous years. With a total volume of over US$300bn transacted across Europe in 2006, cross-border investment captured over 60%, showing a significant trend towards capital going further for higher returns. Russia is capturing an increasing share of cross-border investment with more than 50% of its 2006 investment volumes coming from foreign capital.

Retail Transaction Volumes in Russia, 2006 – Purchaser Type



Retail Transaction Volumes in Russia, 2006 – Source of Capital



In the retail transactions market, domestic developers accounted for over 90% of all the sales transactions whilst the foreign buyers accounted for 70% of acquisitions. A trend that has resulted from:

1. The ability of foreign buyers to achieve more competitive debt terms from Western banks than domestic investors can obtain from Russian banks.
2. Domestic developers looking to sell to foreign companies to improve their reputation.

Immoeast, Meinl and London & Regional have been the most active buyers in the market, not only in Moscow and St Petersburg but also the Regions. An area that is being viewed by many investors as providing more opportunities due to the lack of competition and the availability of freehold title to land. Russian funds such as Troika Dialog have also been acquiring but have tended to focus on smaller lot sizes than those typically targeted by foreign investors.

The major transactions in 2006 include:

- In March 2006, London & Regional Properties purchased two Sun Paradise Shopping Centres, one in Moscow and one in the Moscow region, reflecting an estimated capitalisation rate of 11%.
- Also in March, Meinl European Land purchased two existing shopping centres (Brateevo and Signalniy Mall Galleries) and two lots of land in Moscow from ST Group for US$482m reflecting an approximate capitalisation rate of 10.2%. Meinl European Land proposes to construct shopping centres on the two sites, which should total around 80,000 m^2. Construction is expected to begin in 2007.
- In April 2006, Marta Holding sold 15 of its Prodmak (12 stores) and Grossmart (3 stores) supermarkets to the Marta-Rewe Group joint venture, which will trade under the Billa trademark. By the terms of the deal, Rewe Group bought a 75% stake, and the remaining 25% belongs to Marta. According to market experts, the transaction is estimated at US$70m.
- In May 2006, Divieto Ltd affiliated to the ST Group purchased the Passage Shopping Centre in St Petersburg at public auction for approximately US$48.5m; the starting price was US$8m. The property is situated on 48 Nevsky Prospect, the prime retailing street in the city.
- In November Rodamco Europe, the largest publicly-listed property investment and management company in the retail sector in Europe, announced the acquisition of 50% of the top quality pipeline project – the Metropolis shopping centre development in Moscow – from the international developer and investor Capital Partners. The centre comprises approximately 80,000 m^2 GLA. The investment value for the 50% ownership is approximately €218m, reflecting a 9.6% net initial yield on Rodamco Europe’s total investment cost.
- Austrian investor – Immoeast– acquired two Golden Babylon Malls in Moscow for US$200m in June and the Fifth Avenue Mall in North-Western Moscow for US$150m in December. Along with another Austrian real estate fund, Meinl European Land, Immoeast is currently one of the most active Russian property market investors. The fund is also a minority shareholder in Eastern Property Holdings and Fleming Family & Partners.

Lack of income-producing product was a key issue in 2006 and has led many to invest in forward-purchase and funding arrangements. However, with the dramatic yield compression witnessed throughout the year, from circa 11.5% at the end of 2005 to 9.5% in 2006, many developers/owners are now looking to take advantage of the keen prices being paid for real estate and are open to selling. This is in addition to the growing number of schemes being completed following the current boom in shopping centre development.

With increasing numbers of investors entering Russia and the greater availability of good-quality product, 2007 should be witness to further expansion of the retail investment market. As yield compression continues it is likely that some of the opportunistic investors who entered the market over previous years will look to crystalise profits and exit, whilst increasing transparency and investor confidence are likely to attract the institutional investors to make their first acquisitions in the market.

Conclusion

Russia presents a major opportunity for retailers, developers and investors alike. The country has emerged from a centrally-planned economy to become one of the fastest-growing economies in Europe, with the growth in consumer spending and shopping centre development central to this economic success.

In a market with limited high street opportunities for modern retailer formats, shopping centres will be the retailing format of choice for most retailers and shoppers. The quality of retailers and shopping centres is improving alongside the economic prosperity of Russia and Russians. Strong national retail chains are emerging and an increasing number of international retailers are entering the market.

With a stable political environment, increasing transparency and access to international debt capital markets and still attractive achievable investment yields, the shopping centre investment market will appeal to both domestic and international investors; indeed we have already witnessed the first landmark transactions.

A shopping centre investment market is becoming established with the first investments of Western institutional investors and is forecast to grow substantially as the development pipeline comes on stream; Jones Lang LaSalle forecasts that Russia will be the third largest retail investment market in Europe in 2007, behind the UK and Germany.

The key to acquiring shopping centres in Russia will be the long-term sustainability of individual assets. For the best prime assets, positive rental growth is forecast and yields will come in over the next 12-24 months.

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