

Elevated Elite Expectations

by Chris Willett



When we saw our results from the first quarter we had to ask ourselves, is there really a crisis?" said Galina Tkach. What surprised the director of IntermarkSavills' leasing department was a trend she noticed when analyzing the changes in clients' expectations since the beginning of the year. It appears that the estate agent's clients are looking for larger apartments in more prestigious areas of the city.

"Logically you would have thought that people might have lowered their expectations, but there's no logic here," Tkach said. Indeed, Alexei Pashigorev, managing partner at Amdex Estate, estimated that those who concluded rental agreements before the current economic downturn have experienced up to a 20 percent cut in earnings. "Consequently, clients' requests are corresponding to the situation that has arisen in the market," he added.

Nevertheless, many prospective tenants' expectations of the size and location of their apartments have risen. "Also, many tenants are now trying to include [in their rent] additional services which earlier were the responsibility of the tenant," said Anya Levitov, managing partner at Evans Property Services. Most commonly this means asking landlords to meet their cable, Internet and electricity bills; however, in some extreme cases this extends to expenses on cleaning, cooking and drivers, Levitov added.

What at first might seem a slightly contrary tendency, given the economic slowdown, does have a rational explanation. Those who have been fortunate enough to escape the tightening of corporate purse strings are looking to take advantage of the current situation. Tenants who have not had their salaries cut are saying "Maybe, now I want to live at Patriarch's Ponds, not outside the ring, or perhaps, I'd prefer

a three-room rather than a two-room apartment," explained Tkach.

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Until recently many tenants had lowered their expectations and been pushed by landlords' rent demands to settle for less. However, now they are hoping to command more for their budgets, as previously overvalued apartments come on the market at lower rates. Landlord-tenant dynamics in Moscow's elite rental property market have turned about face.

While this price correction has prompted those whose material situation has not changed dramatically to try and improve their conditions on the same budget, others are looking to reduce their current rates or find somewhere less expensive. "The mass redundancies and cuts in bonuses and income have led many to reconsider their expenses," said Pashigorev. "Many tenants are moving from expensive apartments to cheaper ones," he added.

An analysis of demand in the elite residential rental market throws up a complex picture. Although it has fallen across the board, "the demand for elite properties has always been specific," said Pashigorev. While those with long-term rent agreements are taking advantage of the situation, others who were renting elite apartments while waiting for the completion of finishing work on their own properties have greatly decreased in number.

Overall demand for high-end apartments has remained steady; however, the price distribution has changed, according to data from IntermarkSavills. Demand for elite apartments with rents below \$4,000 per month increased by 20 percentage points in the first quarter of 2009. This brings its total share of demand in the high-end sector to 47.0 percent. At the opposite end of the segment, demand for apartments over \$15,000 per month fell by three percent over the same period.

A number of reasons are believed to be behind this. Firstly, with inflation rising and incomes decreasing demand within the segment is concentrating in the lower price brackets. Secondly, many individuals who can afford top-end prices are taking a wait-and-see approach, postponing searches until the market reaches the bottom. This also means waiting until landlords accept the situation and feel compelled to react. "Many owners have not yet got used to the current situation," Pashigorev said, adding that this often complicates negotiations.

However, activity on the market does not necessarily mean deals. The overall number of transactions is declining, said Levitov. With rent levels a common topic of conversation and a source of media speculation, many tenants are turning to estate agents to check they are getting the best deal or to help them renegotiate their rates. "Much of the increased activity doesn't result in a transaction: clients do a thorough survey of the market then settle a new deal with the current landlord," explained Levitov.

Another complicating factor specific to the elite segment is the role of corporate clients. There is little incentive for those who receive a corporate allowance to negotiate their rent down. "Such tenants are more interested in upgrading the housing they got

on their allowance and get a bigger better place for the money they get from their company," said Levitov.

Meanwhile, fewer companies are renting apartments for their employees directly. It is difficult to calculate by how much the number has fallen, explained Tkach, as it depends on how corporate clients are defined. But she placed the figure at around 15 to 20 percent over this quarter. With the slowdown in recruitment fewer expat executives and senior managers are arriving in Moscow. Consequently, some estate agents are noticing an adjustment of the foreigner-to-Russian ratio among prospective tenants. Yet this is difficult to substantiate across the market as agencies have different client bases.

While the situation regarding demand is complex, overall supply has clearly increased. Approximately 23 percent more elite apartments were on offer in the rental market in the first three months of 2009 according to IntermarkSavills' quarterly report. Attributed in part to a fall in take up, caused primarily by reduced corporate demand, the increase began at the top end of the segment.

Instability on the sales market has also, at least in the short term, contributed to an increase in the supply of elite rental properties. Sellers who are not under pressure to make a quick deal are sheltering in the rental market, waiting for high sales prices to return. However, newly completed apartments acquired as an investment are unlikely to have a significant effect on supply until late 2009 or early 2010 as they require fitting out before release onto the rental market.

The economic downturn and salary cuts are providing a further source of supply. Many of those who took advantage of the previously growing mortgage market are letting their apartments to cover their mortgage payments.

The extent to which supply will continue to outpace demand is unclear. "Supply in the future will be limited as there is little new construction," said Tkach. The central districts of the city, where supply is concentrated,

will experience a specific slowdown in construction as a result of the ban on infill construction, she added.

Although overall the supply volume has increased, its composition has changed little. Three-room properties still account for a little under 40 percent of the total, with two- and four-room apartments, as at the end of 2008, both balanced between 20 and 25 percent, according to IntermarkSavills' data.

The location breakdown is equally static. The highest concentration of top-end rental properties remains the Arbat-Kropotkinskaya district, while the Patriarch's Ponds and Lubyanka-Kitai-Gorod areas are still undersupplied. Leninsky and Leningradsky Prospekts, which emerged as hot spots for elite rental accommodation in 2008, have maintained their shares of the market.

One characteristic that has changed over the first quarter is the distribution of asking rental rates. The percentage of elite accommodation on offer for rent at less than \$4,000 per month has increased by 13 percentage points to 53.3 percent of total supply. This is linked to the fundamental changes in rental rates across the market.

Since the beginning of the final quarter of 2008 rents have decreased at a rate of 15 to 20 percent per month, according to analysis by Penny Lane Realty. Different price brackets demonstrated varying reactions.

Apartments with rents between \$3,000 and \$7,000 per month are now being offered at a discount of 30 percent, while those in the \$7,000 to \$15,000 bracket have been reduced by 40 percent. At a conference at the end of the first quarter Andrei Sado, the director of Penny Lane's elite residential rental department, explained that he could not put a figure on the discount on rates over \$15,000 per month. Such apartments are few and usually owned by wealthy individuals who do not derive their primary income from rent and so can wait for the prices they want, regardless of the market. This makes any analysis of this bracket highly unreliable, Sado explained.

However, Tkach is not keen to describe the decreases in specific figures for particular price brackets. Rather, she argues, the rate reductions are the result of the correction of the many overvalued properties across the price range.

Having looked at a neighboring apartment, many landlords set similar rents, despite discrepancies in the quality of the properties. They can no longer get away with this, Tkach said. "The crisis has brought a stop to the never-ending growth of rents," she added.

Company data put the average price of an apartment across the whole elite rental segment at \$5,360 per month. This is down \$1,080 since the end of 2008.

One final trend that has become clear over the first quarter of 2009 is the increase in the number of contracts concluded in currencies other than the ruble. For the past two years the ruble has been the currency of almost 95 percent of contracts, Tkach said.

Over the first quarter of the year, with the currency changes and the devaluation of the ruble, landlords have been looking to fix rates in either dollars or euros. Tenants have again begun using currency as a bargaining chip in their attempts to negotiate better deals. Consequently, the share of lease agreements concluded in dollars, linked to the Central Bank's exchange rate, has risen to approximately 53 percent, according to IntermarkSavills. 

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A comparison of demand and budget for elite residential rental property in Moscow

