AEB

4th QUARTER, 2010

REAL ESTATE MONITOR

Contents

Chairman of the AEB Real Estate Committee

Dear Real Estate Professionals, welcome to the 4th quarter real estate publication, coming to you a little late by virtue of the holiday season and competing demands on our time as the market continues to show signs of recovery. There are indeed signs of recovery, albeit measured recovery. The office sector continues to dominate the market activity, followed by the warehouse and industrial sector. Increased consumer confidence continues to manifest itself in increased retail sales, with resultant strengthening in demand for retail space in quality shopping centers. Vacancy rates for A and B class office accommodation are continuing to decline, and rent rates in CBD areas are showing signs of rebounding. In the hotels sector occupancy rates are also on a positive growth curve.

This quarters Monitor contains informative commentary on some of the legal aspects pertaining to land plot and town planning issues with respect to the Skolkovo Innovation Center, together with an overview of proposed changes to bankruptcy laws and the impact on participatory construction.

I would like to take this opportunity to thank those of our Real Estate Committee members who have been active in contributing to this publication, to the position paper, to the activities of the Working Groups and to the conference activities. As we move into a strengthening business cycle, so increase the demands on our time and the potential for the amount of time devoted to the activity of the Real Estate Committee to diminish - it is my view, however, that we collectively stand to gain a lot more if we remain focused on our objectives and continue to come together to exchange information and to foster the continued evolution of the real estate sector in Russia.

Many of us will have recently returned from MIPIM and I hope that you used this time wisely to get (re)connected and to promote your business endeavors. I look forward to seeing many of you at our upcoming Real Estate Committee events.

Yours truly

Richard J Gregson

Richard Gregson

Real Estate Committee New Structure

Real Estate Committee
Richard Gregson
Chairman
Real Estate Leader,
PricewaterhouseCoopers, Russia

Steering Committee
- Chairman
- Leaders from each Sub-Committee (Deputy Chairs)

Membership and Operations:
Christophe Vicic

Chief Operating Officer
Jones Lang LaSalle,
Russia & CIS

Finance and investment:
Olga Arkhangelskaya

Ernst & Young
Head of Real Estate
Advisory Services

Industry sub-sectors:
- Office
- Residential
- Retail
- Industrial/warehouses
- Hotels

Tim Millard

Managing Partner Russia and
CIS Cushman & Wakefield

External Affairs - Government relations & coordination with other associations:
Arnaud Dubois

IMAGIM Ltd
Managing Director Partner
Global Real Estate Solution

Project Management and Ancillary Services
to be decided

AEB Committee
Irina Guruleva

Committee
Coordinator

Past & Upcoming Events

Past events

- 07.10.2010 General committee meeting & Sundowner
- 12.10.2010 Sub-sectors working group meeting
- 19.10.2010 Membership & Operations Working Group meeting
- 11.11.2010 Sub-sectors working group meeting
- 18.11.2010 Sub-sector working group event: "Green office: fancy trend or way out of the crisis"
- 25.11.2010 Finance & Investment working group event: "Banks as owners of real estate: risks, challenges and ways to move forward"
- 07.12.2010 Membership & Operations Working Group meeting
- 08.12.2010 AEB 15th Anniversary Celebration
- 14.12.2010 Steering committee, general committee meetings & Sundowner
- 28.01.2011 Steering Committee meeting and Committee Dinner

Upcoming events

- 23.03.2011 Meeting of Finance & Investment Working Group
  Venue: Ernst & Young
- 24.03.2011 Steering Committee, general committee meetings & Sundowner
  Venue: PwC premises
- 29.03.2011 Membership & Operations Working Group meeting
  Venue: Kinnarps Office
- 07.04.2011 Finance & Investment Working Group open event: "How to set up a manufacturing plant in Russia"
  Venue: AEB premises

Real Estate Market Snapshot Review: Capital Market

The growth of investment in Russian commercial real estate in 2010 largely exceeded expectations, reaching 43% compared with the previous period: the total volume of investment reached $4,171 billion compared with $2,919 billion in 2009.

The office segment accounts for 64.9% of the total investment volume in commercial real estate in Russia (in 2009 the share of the office segment reached 74.7%).

The share of investment in the warehouse and industrial segment of commercial real estate rose from 0.2% in 2009 to 14.1% in 2010. Shares of other segments – retail, hotel and multifunctional – reached 6.2%, 2.4%, and 12.4% respectively as of the end of 2010.

The share of deals involving foreign funds in the total volume of investment is still rather low – 14% for 2010.

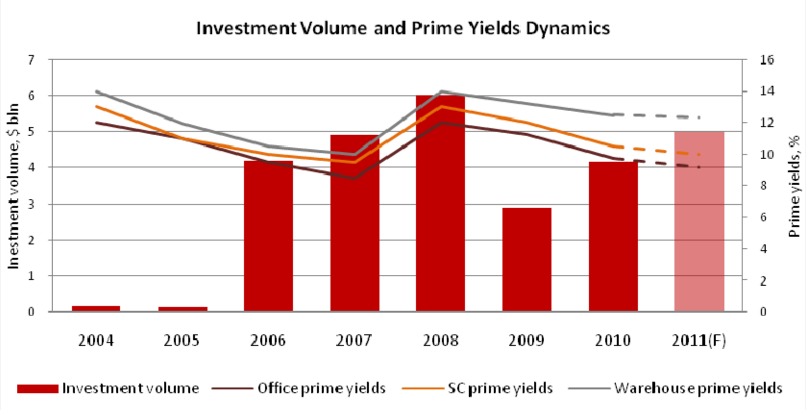
The share of acquisitions of commercial properties by end-users in the total volume of investment dropped to 13% in 2010 from 24.9% in 2009. A large number of properties purchased in 2010 (87% of the total investment volume) have been purchased for investment purposes.

In 2010, the share of investment in real estate properties located in the regions of Russia grew slightly – to 8% from 5% in 2009, of which St. Petersburg accounts for 42.7%.

The capital markets segment of commercial real estate has been showing signs of revival throughout the year. The most active players in this market were large banks with government shareholdings. European banks also demonstrate rather high interest in refinancing completed real estate projects. The credit conditions offered by international banks for such projects are close to pre-recession levels: loans were offered at a USD LIBOR +7-7.5% interest rate, with a loan-to-value (LTV) coefficient of 55-70%.

The revival of the real estate investment market in 2010 (against a backdrop of the gradual growth of the Russian stock market stimulated by increasing crude oil prices) led to a slight decrease in capitalization rates compared with 2009. Thus, by the end of 2010, the capitalization rate reached 9.5-10% for high class office buildings, 10.25-10.75% for high class retail properties, and 12.25-12.75% for appealing assets in the warehouse and industrial segment.

It is expected that capitalization rates will continue decreasing throughput 2011 (although rather slowly) and the volume of investment in Russian commercial real estate will grow approximately 20%, reaching $5 billion.



Source: Praedium Oncor International

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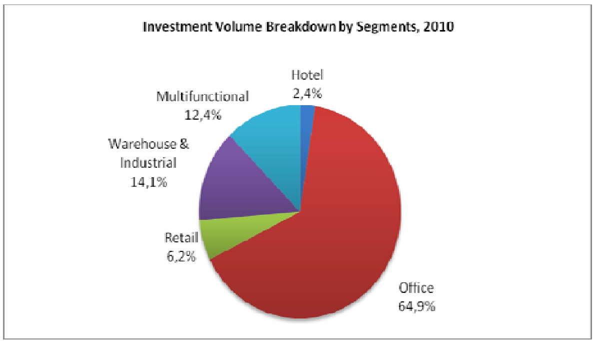
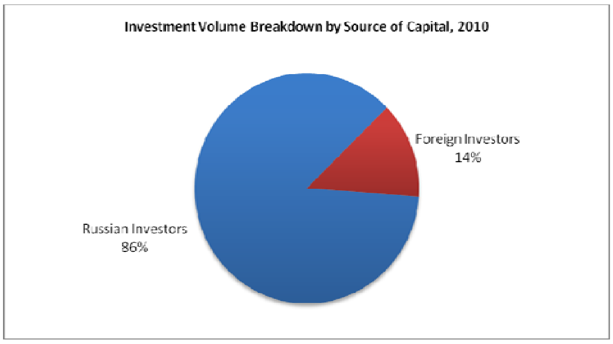
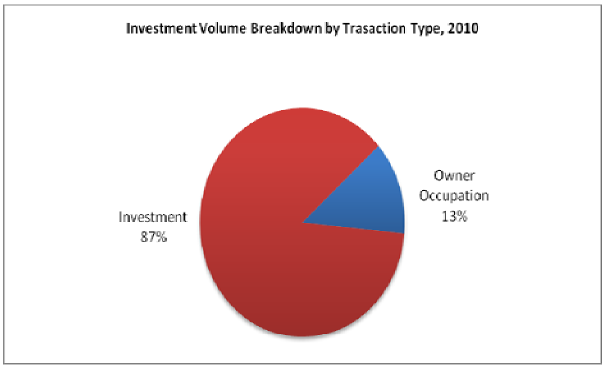
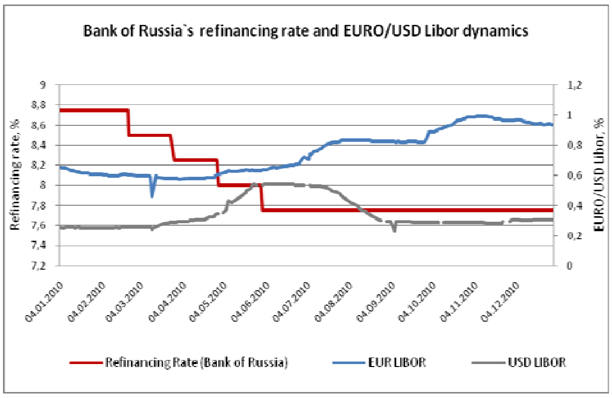


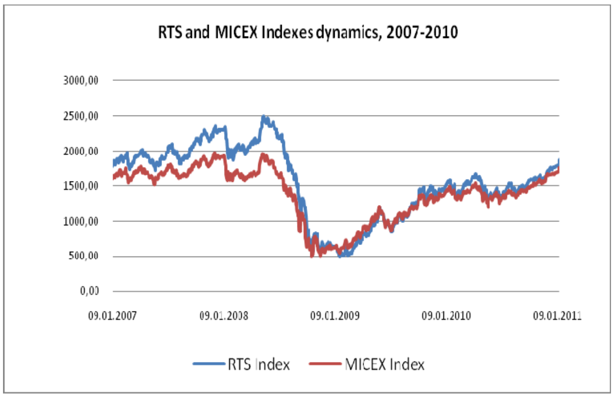


Source: Praedium Oncor International



Source: Bloomberg, Central Bank of Russia, Praedium Oncor International





Source: RTS, MICEX, Praedium Oncor International

Real Estate Market Snapshot Review: Retail Sector

An improving labour market and positive income growth rates translated into retail sales increasing 4.5% YoY in January-November 2010. We expect a comparable performance in 2011, as the negative effect on revenue from higher payments to social programmes will be offset by a moderate decrease in the saving rate of households, which will support internal demand growth (and the retail sector).

Shopping centers

Although a large volume of shopping centre space (83,000 sq m) entered the Moscow market in Q4, the vacancy rate has not increased. In fact, the vacancy rate in Moscow remained unchanged - 7% in Q4 2010. We expect Moscow's vacancy rate to gradually decrease, as there will be a limited new supply of shopping centres. Whereas, in other major Russian cities this process will be relatively slower, as new supply comes to the market in the near future.

We see tenant activity continuing to increase, especially in new shopping centres occupancies. Six months ago tenant interest was concentrated in the key markets of Moscow and St. Petersburg, but is now spreading to the whole of the country.

Following the recovery of retailer demand, some developers are now resuming construction of previously frozen schemes or considering new projects. Although the project pipeline is increasing, there will be a lack of new shopping centre premises on the market in the near term. Taking into account strong retailer demand, we expect vacancy rates in existing quality shopping centres to decline over the next one or two years. A declining vacancy rate, in turn, will drive rental rates up the following year.

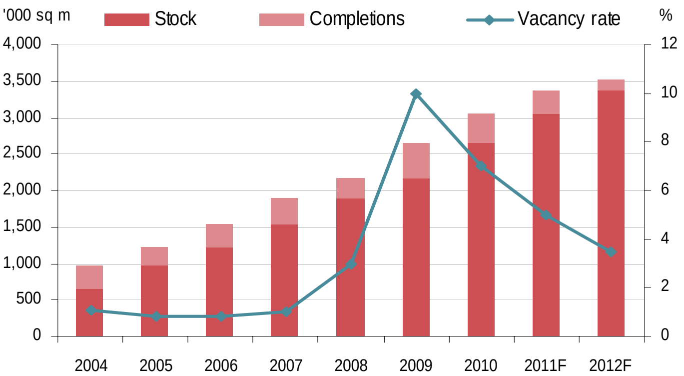
Q4 2010 SC rents and yields

Indicator		Moscow		St. Petersburg	
		min	max	min	max
Prime SC base rent*	USD/sq m/year	2,700	4,000	1,300	2,000
Average SC base rent	USD/sq m/year	500	1,350		
Prime street retail base rent	USD/sq m/year	3,000	4,500		
Prime SC yield	%	10.0	10.5	12.0	12.5
Vacancy rate	%	7.0		7.0	

* Represents the net rent that could be expected for a notional prime position shop situated in the best shopping centre.

Source: Jones Lang LaSalle

Moscow market balance



Source: Jones Lang LaSalle

Moscow project pipeline

Name	Announced year of opening	GLA, sq m
AFIMALL City	2011	114,000
Severnoe Siyanie	2011	12,250
Favorit Centre	2011	24,000
River Mall	2011	85,000
Fashion House Outlet Centre	2011	26,765
Outlet Village at Belaya Dacha	2011	38,000
Kaleidoskop	2011	35,000
Parus	2012	17,150
GoodZone	2012	70,000
Tverskaya Zastava	2013	37,000
Mozaika	2013	64,000

Source: Jones Lang LaSalle

Street retail

Rental rates for street-retail premises went down to 30-40%, during the sharpest phase of the crisis (H1 2009). Rental rates for some of the top premises located on the first row of the central shopping streets were more than 50-60% lower than before the crisis when they exceeded $15,000/sq m/year.

The recovery of the street-retail market was already seen in H2 2009: rental rates in some segments began to grow. Rental rates for premises, located in bedroom communities, have now returned to pre-crisis indicators. At the same time, top premises located on central streets, which were considerably overpriced before crisis, are still being leased for 30-50% less than before the crisis.

Growing demand from retailers, who faced a lack of supply in prime shopping centers, will boost rental rates of Moscow's central street retail premises in 2011 – the growth of average rate will reach 10-15% a year. There are good opportunities in new residential districts: 1st floors of residential buildings in developing communities form a potential segment of the street retail market into which large retailers could expand.

Aggregate volume of street–retail space on central retail corridors, '000 sq m	410
Share of vacant space, %	1,0-7,0%
Aggregate volume of street–retail space on main retail streets, '000 sq m	150
Share of vacant space, %	1-7,5%
Base rental rates, $ per sq m per annum*	
Central retail corridors	1,300-5,500**
Main retail streets	700-2,500**
Space on 1st floors of residential homes in bedroom communities	500-1,200**

1.*Excluding operating expenses and VAT (18%)
2.**Rates for stores with areas around 200 sq m

Source: Knight Frank Research, 2010

Moscow prime street retail rents, Q4 2010

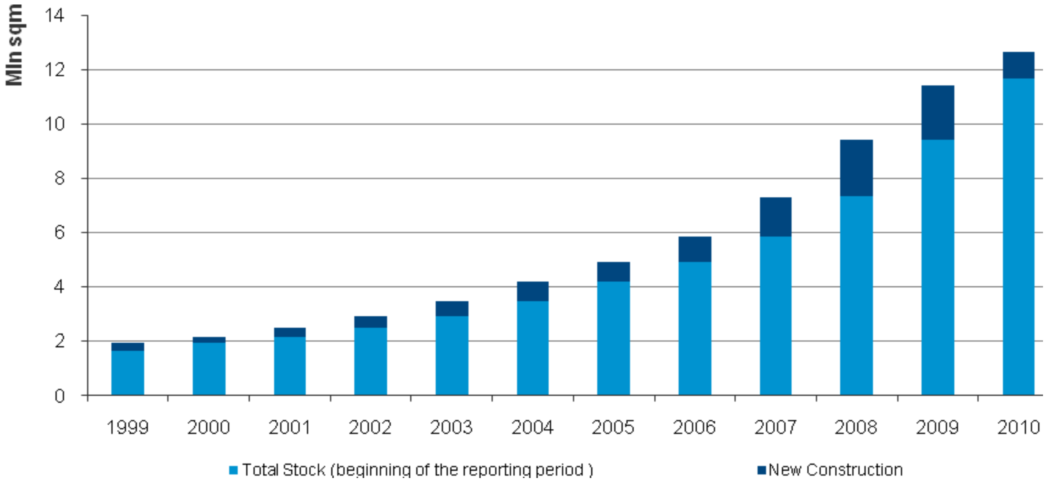
	Minimum	Maximum
Tverskaya street	3,000	4,500
1 Tverskaya-Yamskaya Street	1,200	2,500
Novy Arbat	1,500	2,500
Kuznetsky Most	1,500	4,000
Kutuzovsky Prospect	2,000	3,500
Leninsky Prospect	1,000	3,000
Prospect Mira	1,000	2,000
Sadovoe Koltso	1,500	3,000
Krasnaya Presnya	1,000	2,200
Stoleshnikov Lane	4,000	10,000
Petrovka Street	1,500	4,500
Patriarshie Prudy	1,500	3,000
Ostozhenka Street	1,000	3,000

Source: Jones Lang LaSalle

Real Estate Market Snapshot Review: Offices

In 2010, the amount of commissioned space was considerably lower than in the previous several years, when approximately 1.5–1.8 million sq m of office space had been commissioned annually. Major projects completed in 2010 were: Nagatino i-Land Ph I (6 buildings, totalling 154,745 sq m); Preo 8 (75,000 sq m); Domnikov (64,100 sq m); and, Western Gate (56,000 sq m). In 2010, 970,000 sq m of new office space was commissioned, with Class A properties accounting for 34% and Class B properties for 66%.

Total stock and new construction, Classes A and B

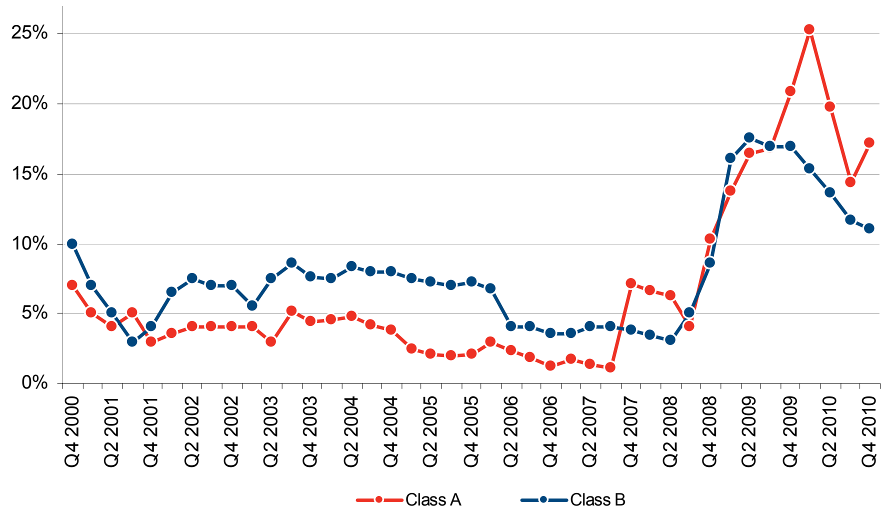


By the end of 2010, the total stock of Class A and B office space was 12.64 million sq m.

Recovering demand and growing take-up, typical of the office property market in 2010, provided for a decrease in vacancy rates. As at the end of 2010, the vacancy level was at 1.5 mln sq m. The average vacancy rate in Moscow office buildings is 12% (for class A offices – 17.1% and for class B offices – 11.0%). In Q4, the vacancy rate for Class A premises increased slightly (to 17.1% from 14.3%), following the commissioning of approximately 160,000 sq m of office space and, correspondingly, an increase in supply. This is comparable with the total area of Class A properties commissioned in the first three quarters of 2010.

Source: Colliers International

Average vacancy rates



In 2010, we saw a gradual stabilisation of rental rates in H1 followed by a slight increase in H2. The most significant growth was registered for business centres located in the central business district. As at the end of 2010, weighted average rental rates in the central business district were $760/sq m/year* for Class A; $660/sq m/year for Class B+; and, $390/sq m/ year for Class B– properties. For comparison, in the beginning of the year rates were $660/sq m/year for Class A; $560/sq m/year for Class B+; and ,$300/sq m/ year for Class B–. Outside the central business district, weighted average rental rates for office premises remained virtually the same as the beginning of the year - approximately $450/sq m/year for Classes A and B+ and $220/sq m/year for Class B–.

* Hereinafter, rental rates are stated net of VAT and OPEX

Asking rental rates and sale prices in 2010

Building class	Asking rental rates, $/sqm/year (net of VAT and OPEX)	Sale prices, $/sqm (net of VAT)
Class A	550–1,000	7,000–12,000
Class B+	300–750	3,000–8,000
Class B–	200–550	2,000–6,000

Source: Colliers International

Real Estate Market Snapshot Review: Warehouse market

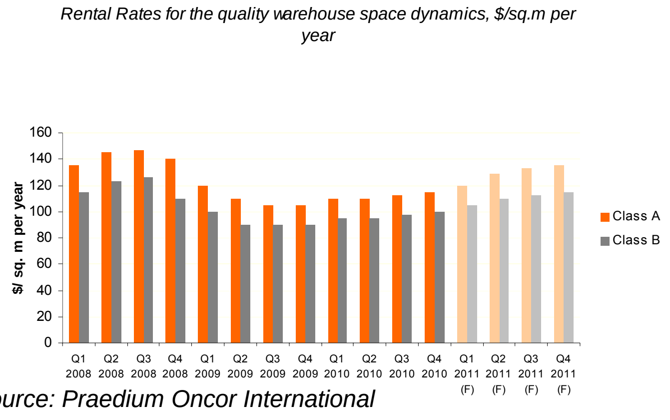
In 2010 in the warehouse segment of the commercial real estate market was characterized by a sharp change of the overall environment: after a period of low demand and decreasing rate of new construction, H1 2010 brought about a significant growth of tenants' activity and following this, a recovery of the developer market, as many developers announced plans to deliver new warehouse space.

Throughout 2010 there was a clear trend toward higher rental rates: rental rates for high quality warehouse space rose 9-11%. There was an unprecedented fall in the vacancy rate to 7% in December from 12% in the beginning of the year. Given the recovery of demand and growth of rental rates, most professional warehouse developers announced new projects. Developers, including MLP, PNK, and Hines, announced intentions to start construction of new phases of existing warehouse developments. Overall, by the end of 2011 some 550,000 sq m of high quality warehouse space may be delivered ,which is 25% more than the total volume delivered in 2010, yet is 20% less than in 2009. The total volume of transactions in the warehouse segment for 2010 reached 750 000 sq m, which is 10% higher than 2009 and 15% more than 2008. There has been a significant increase, not only in the number of transactions, but also in the size (area) of the blocks leased. The largest deals in the warehouse market in 2010 were: Arkonada, leasing 32,500 sq m at A-Terminal Logistic Park; SkladLogistik, acquiring 25,780 sq m at Krekshino Logistic Park; and, two deals in PNK-Chekhov – 23,000 sq m rented by Mitsui, renting 23,000 sq m and X5 Retail Group, renting 22,006 sq m. .

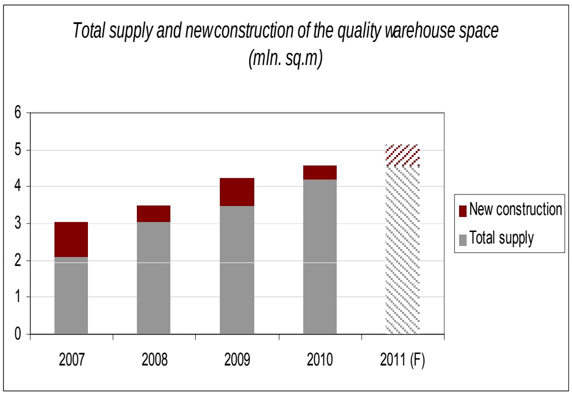
Large lease deals in the warehouse market in 2010 were not limited to properties located in Moscow and the Moscow Region. There was also significant interest in warehouse space in Russia's large regional centres. Large lease deals were completed in Yekaterinburg (Pyshma Logopark), Kazan (Biyek-Tau warehouse complex), and St. Petersburg (Shushary, MLP Utkina Zavod, Kulon Pulkovo, Gorigo warehouse complexes). There was also a revival in the warehouse development segment: Mirland Development Corporation has announced it intends to build a Class A logistic complex in the Saratov Region, with a total area of 150,000 sq m; Germany-based logistic services provider SIF&B plans to invest over EUR 1 billion in the Vorsino Industrial and Logistic Park in the Borovsk District of the Kaluzhskaya Region.

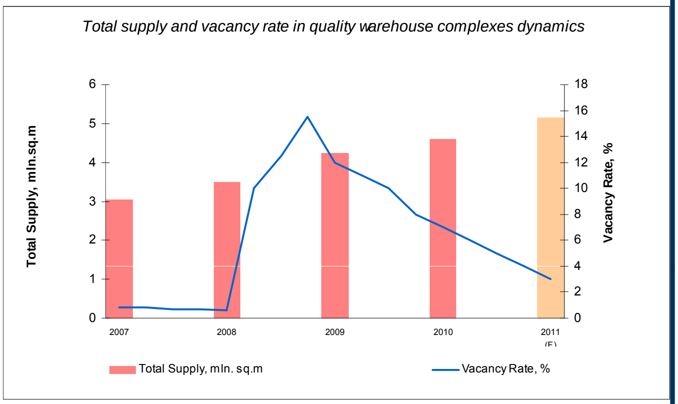
One of the major trends in 2010 was growing interest in purchasing warehouse properties and built-to-suit schemes.

The positive trends that appeared in the warehouse segment in 2010 are likely to continue in 2011. Rental rates are likely to continue increasing and growth may reach 15-20% by the end of 2012. It is expected that, given tenants' and buyers' keen interest in warehouse space, if all the properties announced for 2011 are delivered on time, the vacancy rate for Moscow's warehouse segment may drop to 3-4%. If the Moscow developers' plans are not 100% completed, there will be a deficiency of high quality warehouse space by the end of 2011.



Source: Praedium Oncor International





Source: Praedium Oncor International

Examples of the largest warehouse deals closed in 2010

Property	Tenant	Area, sq. m
A-Terminal Logistic complex	Arconada	32,500
Krekshino logistic park	SkladLogistic	25,780
PNK-Chekhov warehouse complex	Mitsui	23,000
PNK-Chekhov logistic complex	X5 Retail Group	22,006
Trilogy Park Tomilino warehouse complex	Univeg	22,000
Trilogy Park Tomilino warehouse complex	Axima	22,000
Trilogy Park Tomilino warehouse complex	Auchan	21,872
Severnoe Domodedovo industrial and logistic complex	UNICS	21,700
Class B warehouse complex in Podolsk	Gulliver	21,500
BCRE Lobnya warehouse complex	Schneider Electric	19,241
Vostochny industrial park	Centralny Division	15,700
Trilogy Park Tomilino warehouse complex	Vinexim	14,500
Krekshino logistic park	S-trade	11,080
Warehouse complex in Troitse-Lykovo	TNT Express	10,885

Source: Praedium Oncor International

Real Estate Market Snapshot Review: Hospitality

Overall, there was a 4% increase in occupancy across all market segments of Moscow hotels in 2010. Both the dollar and rouble ADR (average daily rate) continued to decline (5% and 9% respectively). Thus, a slight 2% increase of RevPAR (revenue per available room), set in dollars, was seen on a YTD basis. The average rouble RevPAR dropped 3%. Differently directed movements of RevPar (depending on the currency of this indicator), can be explained by rouble appreciation against the US dollar in 2010 compared with 2009. Growth of RevPar (nominated in US dollars) was registered in all hotel segments.

There is a trend of customers shifting toward either more expensive and quality deluxe hotels, which raised competitiveness by keeping prices relatively low, or midscale hotels, which are the most attractive to price sensitive customers. Thus, visible demand is increasing in the mid- and up-scale hotel segments. Nevertheless, it may be assumed that this trend will not continue in the long-term because, along with the return of business customers, their paying capacity will increase and deluxe hotels will gradually increase their rates to pre-crisis levels.

The upscale hotel segment indicated the best results, reaching the highest dollar RevPAR growth of 8% ($169). This increase was achieved by a 4% rise in occupancy and only a nominal drop of ADR set in dollars (less than 1% vs. 2009). Rouble rates decreased 6% (RUR 9,459). Rouble RevPAR increased 2% and was RUR 5,043 (vs. RUR 4,924 in 2009).

Business hotels remained virtually at the same level, showing a 2% dollar RevPAR increase ($137), which was the result of a 4% rise in occupancy balanced by a 3% dollar ADR decline. ADR, set in roubles, decreased 8% in line with a 3% decline in rouble RevPAR (RUR 4,102).

In the midscale segment, a 10% RevPAR increase was seen by the end of 2010 ($97). Occupancy increased 7% and there was a 3% decrease in dollar ADR. Rates set in roubles declined 7%, but the rouble RevPAR average indicator, owing to a solid occupancy increase, demonstrated a 5% increase (RUR 2,896) compared with 2009.

An absolute gap in RevPAR between the segments continues to narrow. The difference between the mid- and up-scale segments decreased to USD 72. The difference in RevPAR between upscale and business hotels decreased to USD 32.

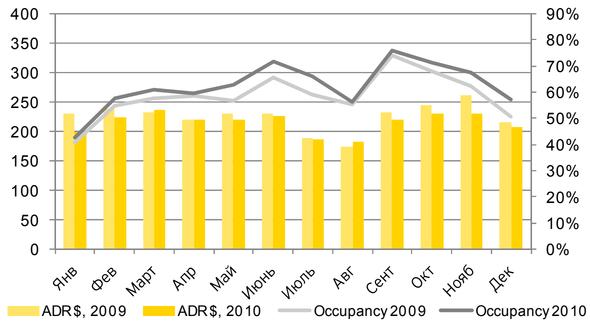
During Q4 2010 no hotels were opened in Moscow. However, for full-year 2010, the total supply of hotel facilities increased by six properties (1,692 rooms), of which three are managed by international operators (1,172 rooms). In 2011, we expect a gradual increase of existing hotel supply and the resumption of construction of stalled hotel projects. In line with the reduction of entry barriers to the market during the crisis and post crisis period, there is a visible expansion of operator presence.

Future hotels, planned for opening in Q1-Q2 2011

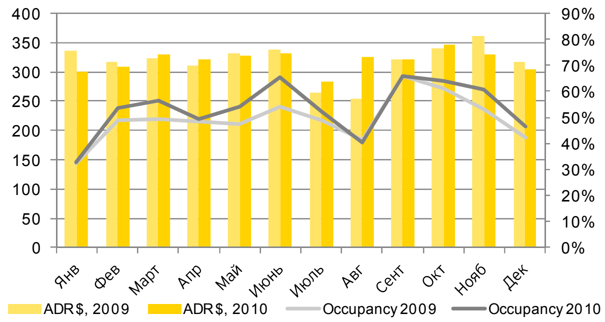
Name	Room number	Address	Class
InterContinental Moscow Tverskaya	205	Tverskaya Str., 22	5 stars
Kempinski Hotel Nikolskaya	200	Lubyanskaya Square	5 stars
Courtyard Moscow Paveletskaya (Mixed-use complex Vivaldi)	170	Kozhevnicheskaya Str., 8/4	4 stars
Radisson Belorusskaya	264	Yamskoe Pole 3-ya Str., 26	4 stars
Azimut in Danilovskaya Manufaktura mixed use complex	134	Varshavskoye Highway, 9, Bldg. 1B	3 stars

Source: Ernst & Young

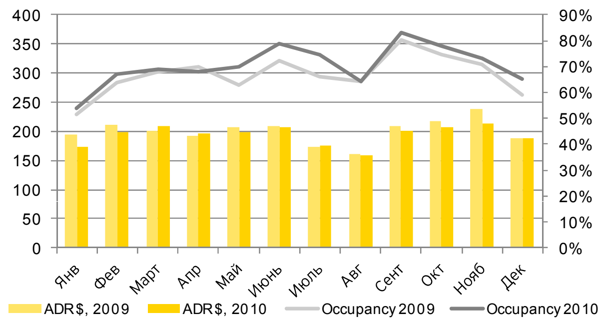
Average market ADR ($) and occupancy dynamics, Moscow hotels, 2010 vs. 2009



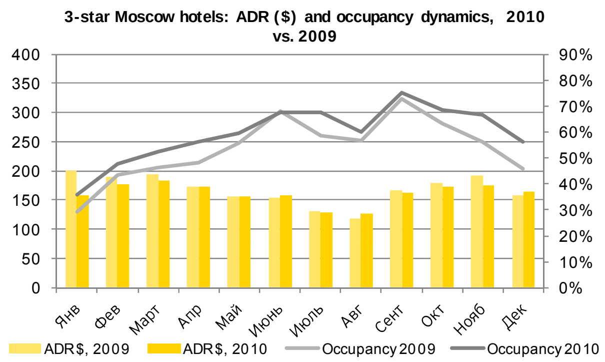
5-star Moscow hotels: ADR ($) and occupancy dynamics, 2010 vs. 2009



4-star Moscow hotels: ADR ($) and occupancy dynamics, 2010 vs. 2009



3-star Moscow hotels: ADR ($) and



Operational indices dynamics

	January - December 2010	January - December 2009	2009	January - December 2010 / January - December 2009, %	January - December 2010 / 2009, %
			5 stars		
Occupancy	53%	49%	49%	4%	4%
Average daily rate (ADR)	9459 р. / 316 $	10027 р. / 318 $	10063 р. / 320 $	-6% / -1%	-6% / -1%
Revenue per available room (RevPAR)	5043 р. / 169 $	4964 р. / 158 $	4924 р. / 156 $	2% / 7%	2% / 8%
			4 stars		
Occupancy	70%	67%	67%	3%	4%
ADR	5830 р. / 195 $	6317 р. / 200 $	6350 р. / 202 $	-8% / -3%	-8% / -3%
RevPAR	4102 р. / 137 $	4236 р. / 135 $	4225 р. / 134 $	-3% / 2%	-3% / 2%
			3 stars		
Occupancy	60%	54%	53%	6%	7%
ADR	4835 р. / 161 $	5307 р. / 168 $	5206 р. / 166 $	-9% / -4%	-7% / -3%
RevPAR	2896 р. / 97 $	2791 р. / 89 $	2759 р. / 88 $	4% / 9%	5% / 10%
			Average		
Occupancy	62%	59%	58%	4%	4%
ADR	6441 р. / 215 $	7094 р. / 225 $	7115 р. / 226 $	-9% / -4%	-9% / -5%
RevPAR	4023 р. / 134 $	4158 р. / 132 $	4133 р. / 131 $	-3% / 2%	-3% / 2%

Source: Ernst & Young

Real Estate Market Snapshot Review: Elite Real Estate Rental Market

According to research carried out by MAYFAIR Properties' analytical department, in H1 2010 the most in-demand apartments were those with rental rates of USD 3,000-5,000 (80% of clients). The percentage of clients with a budget of over USD 5,000 was13%, while 7% had budgets over USD 10,000. H2 2010 was marked by a growing number of clients with budgets exceeding USD 5,000: the greatest demand was for apartments with rental rates of USD 3,000-5,000 (60% of clients), while 31% of clients had budgets over USD 5,000 USD and 9% over USD 10,000.

As the analysis of Q3 2010 suggests, the most in-demand apartments are usually those in the Central Administrative District of Moscow, with the most expensive offers in the Golden Mile area and around the Patriarchy Ponds (up to USD 35,000 per month).

The structure of demand has undergone considerable changes: before the economic crisis the majority of tenants in the business and elite segments of the market were mainly foreign top-managers of Western and Russian companies, whereas after 2009, tenants are mostly Russian citizens, as many large companies reduced the number of foreign top-managers in order to cut costs. The Russian economy showed certain stability in 2010, leading to an increase in the scope of business activities of foreign companies doing business in Russia, especially in retail, the FMCG market, automobile producers and dealers, and others. Thus, an influx of foreign tenants could already be seen in 2010, and it seems reasonable to expect further steady growth in demand in 2011 from both foreign and Russian tenants.

Moreover, with very few primary offers in the sales market, this will clearly influence a price surge in the rental market, as marketable and high-quality offers will be limited, although in high demand. According to our estimates, in 2011, the growth of rental market rates will average not less than 10-15% per year, while traditionally the most in-demand offers are in such areas as: Patriarshy Prudy, Ostozhenka, Tverskaya, buildings with exceptional views located in the Zamoscvorechye area, Kotelnicheskaya embankment, Chistye Prudy, as well as cottage compounds within Moscow (e.g. Serebryany Bor/ Silver Forest, Godunovo, Chayka, Pokrovskie Kholmy), and in the Moscow suburbs close to the centre (Rosinka, Zhukovka 2-3, Barvikha-2, CLUB, etc.).

Number of rooms in apartment	Minimum (USD)	Maximum (USD)
1 room	1,200	4,000
2 rooms	1,500	6,000
3 rooms	2,500	10,000
4 rooms	4,500	20,000
5 and more rooms	7,500	25,000

Direction	Sq. m	Price ($)
Rublevo-Uspenskoe, Novorizskoe	300-1,000	5,000-6,0000
Mozaiskoe, Kievskoe, Kaluzskoe, Dmitrovskoe	150-700	3,000-30,000

Real Estate on the Territory of the Skolkovo Innovation Center: Legislative Innovations

Further to an initiative of the President of the Russian Federation, Dmitry Medvedev, the construction of the Skolkovo Innovation Centre will start. The centre will be in proximity to Moscow and will be home to companies developing state-of-the-art technologies in information technologies, telecommunications, nuclear physics and biomedicine.

The area set aside for the development of the Skolkovo project covers approximately 400 hectares and is located in the residential area of Novo Ivanovo, which is approximately 2 kilometers to the west of the Moscow Ring Road on the Skolkovo highway. According to information on the Skolkovo project's official web site, (http://www.i-gorod.com/), the geotechnical, geodesic and environmental investigations have already been completed. The layout for utilities has been designed and the connection points have been determined. In addition, all source specifications for utilities connection have been received. Skolkovo's town-planning concept is currently being discussed; on 20 February 2011 the Foundation for the Development of the Center of Development and Commercialisation of High Technologies (hereinafter the **Foundation**) was set to select one of the two area development concepts proposed by architects (AREP (France) and OMA (Holland).

The relationship of project participants with respect to establishing and supporting the operation of the Skolkovo Innovation Centre (hereinafter the **Project**) is regulated by Federal Law No. 244-FZ *On the Skolkovo Innovation Centre* (hereinafter the **Law**) dated 28 September 2010. According the Law, the implementation of the Skolkovo project has been entrusted to the nonprofit organisation Foundation for the Development of the Center of Development and Commercialisation of High Technologies, registered on 21 May 2010.

Land plots

The Law establishes a number of material differences, when it comes to the regulation of land on the Skolkovo site, compared with the procedure established by the Land and City Planning Codes of the Russian Federation. For example, the separation and/or adding of encumbrances to the land plots is not permitted, with the exception of the transfer of land plots on a leasehold basis for the purpose of implementing the project.

The following parties may lease a land plot: (1) a subsidiary of the Foundation; (2) a project participant ; or (3) a person participating in the implementation of a project. The Law prohibits the transfer of the land plots for subletting.
Only the Foundation will own the title to all the land plots of the Skolkovo Innovation Centre. The Foundation has the right to establish special leasing terms for the land plots, depending on the importance of the tenant's participation in the implementation of a project. It is assumed that these special terms may be, in particular (1) the size of the rent and/or (2) the effective term of the lease. Since a company may acquire the status of project participant for a maximum of 10 years, on the expiry of which the legal entity loses said status (Article 10 of the Law), we assume that the maximum lease term for a land plot will not exceed 10 years.

Construction

In accordance with the Law, the Foundation has been vested with significant authorities regarding the regulation of town-planning activities. For example, the Foundation arranges for the development and approves the documentation, which is used rather than a master plan and dictates the use of the land and development of the Skolkovo Innovation Centre, and also documentation on the planning of the land. At the same time, the Law does not stipulate mandatory public hearings on drafts of said documents, which should expedite the approval process.

Pursuant to the provisions of the Law, the Foundation issues construction permits and commissions properties, performs expert examinations of the planning documentation for capital construction and approves the installation of advertising hoardings. This approach is unique in Russian legislation and may expedite the procedure for issuing construction permits and commissioning properties compared with the standard procedures governing the issuance of these documents by municipal authorities.

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Overview of the proposed changes to bankruptcy law: making participatory construction safer for individuals at the expense of banks?

The draft amendments to the Federal Law "On insolvency (bankruptcy)" (hereinafter **Bankruptcy Law**) are aimed at regulating bankruptcy proceedings against property developers engaged in the construction of residential apartment blocks (hereinafter the **Amendments**). The Amendments mostly deal with bankruptcy-related claims related to pre-sales of residential premises that are under construction, regardless of the various guises under which such pre-sales were sold, as a practical matter. Thus, the Amendments, if adopted, would directly affect the enforcement of the notorious Federal Law No. 214-FZ "On participation in construction of residential apartment blocks and other properties" (hereinafter **Participatory Construction Law**). Enforcement of this law is becoming more and more widespread on the market, if only insofar as mass-market residential construction.

The Amendments were approved in first reading in the State Duma. They were expected to be approved in their second reading in Q4 2010. However, the reading was subsequently moved to January 2011, but an unexpectedly large number of comments from various state authorities and State Duma Deputies, who have taken an interest in the matter, necessitated further work on the draft.

Who benefits -- inclusive rights of claim

Under the Participatory Construction Law, property developers are permitted to attract financing from individuals for the purpose of residential construction, solely under the rules of the Participatory Construction Law, through registrable participatory construction agreements (hereinafter **PCAs**). The use of PCAs has been largely disfavoured by developers until recently, not in the least due to the high standards for construction permitting and disclosure that it imposed. Any other types of arrangements that in effect envisage pre-sales of apartments under construction to individuals may be held null and void. The Amendments, however, put such arrangements, despite their seeming nullity, on the same footing as registered PCAs, thus expressly extending the new bankruptcy regime to claims under those arrangements. All individual claimants with claims against a developer are accorded the status of *participants* on an equal basis, although participants under proper PCAs still have the additional benefits under the Participatory Construction Law, e.g. statutory pledge over the property.

Who is answerable -- novel definition of property developer

The new bankruptcy regime introduces the notion of the "developer", regardless of whether the relevant entity has properly documented property rights to the land plot underlying the development or the apartment block; its usage differs from the word's common legal meaning. The "developer" is merely defined as the obligor under any participants' claims, either for handing the property over or financing it.

Who has the final word – procedural privileges

Participants would hold a privileged position in the bankruptcy proceedings, including with regard to certain procedural issues. For example, a vote of no less than three-fourths of the participants is required for the creditors' council to approve any settlement with the debtor, which is often the preferred way of resolving bankruptcy.

Where to litigate – participants hold sway

Bankruptcy cases are currently tried in the debtor's jurisdiction , whereas the Amendments envisage special jurisdictional rules for bankruptcy proceedings against developers. Under the Amendments a court may, upon application of any party to the proceedings, move proceedings to a court in the jurisdiction of the land plot underlying the development, the apartment block, or even the place of residence of the majority of the participants, if the court considers such a move is in the interest of the participants.

Thus, a foreign or Moscow-based bank lending to a Moscow-based developer may hypothetically end up involved in lengthy and costly proceedings in any jurisdiction where that developer happens to be in trouble building apartment blocks.

Toughened state control to prevent bankruptcy

The Amendments allow the competent authorities to require a developer to adopt bankruptcy prevention measures should certain grounds arise that could lead to the developer's bankruptcy (non-compliance to financial stability standards, repeated suspension of construction, a more than two-month delay of meeting deadlines for apartment transfers). The measures are implemented according to a plan devised by the developer, and may include, among other things, financial aid from the shareholders and restructuring of the developer's assets. The developer’s bankruptcy prevention plan must, *inter alia*, accurately describe the developer's current financial condition. Should the relevant authority discover statutory signs of bankruptcy, it must file a bankruptcy petition against the developer with the appropriate court.

Measures to combat asset stripping

According to the Amendments, in order to safeguard the participants’ interests, a developer is prohibited from engaging in any transactions involving its real property, including apartment block(s) and underlying land plot(s), without the written consent of the bankruptcy administrator. The court trying the bankruptcy case may also order interim relief in the form of prohibiting the landlord from leasing the land plot under the development to any persons other than the developer and prohibiting registration of such lease agreements.

Creditors’ claims rank differently

The Amendments set up a somewhat different ranking of creditors' claims in developers' bankruptcy compared with the general rules of the Bankruptcy Law.

First priority ranking includes personal injury and moral damage claims; second priority is for claims for employees' payments and authors' royalties; third priority is claims of individual participants; and, fourth is claims of other participants (companies, municipalities etc), together with claims of all other creditors. Claims of lending banks are "other creditors' claims" and are ranked fourth, unless they are secured by a mortgage, which is usually the case.

Interestingly, the first draft of the Amendments approved by the State Duma purported ranked claims of individual participants as a third priority, based on their financial standing and living situation. However, the current draft, which is likely to be introduced for second reading in the State Duma, no longer makes this distinction and allows all individual participants to be ranked third, thus the rich and poor are on equal footing in the eyes of the law.

The new rules on claims’ ranking did not, however, affect the general principle of the Bankruptcy Law which calls for on-going operating costs and secured claims (including claims made by participants and other parties, e.g. banks) to be satisfied without regard to the usual priority of creditor's claims. Equally, in line with general bankruptcy law principles, secured claims are satisfied out of the proceeds of a sale of the mortgaged property, although the claims are subject to specific rules regarding the distribution of the proceeds. All participants’ claims under PCAs are automatically secured by mortgage law, whereas claims of participants under any other types of pre-sales arrangement, as well as claims of banks financing the construction, which are not automatically secured unless there is a contractual mortgage arrangement in place.

The proceeds of the sale of a developer’s mortgaged property are to be distributed as follows:
- 60 per cent of the proceeds are to satisfy creditors’ claims secured by a mortgage (all secured creditors are treated

equally, without distinguishing between statutory mortgagees like PCAs participants, banks or other contractual mortgagees);
- 25 per cent satisfies participants' monetary claims, including claims for actual damage (save for interest and other penalties);
Secured claims and participants' claims exceeding the above percentages are ranked 3rd or 4th respectively;
- 10 per cent satisfies claims of 1st and 2nd priority creditors, unless other assets of the debtor suffice for this purpose (if such other assets do suffice, the relevant 10 per cent of the proceeds is used to satisfy the secured creditors' claims and the above mentioned participants' monetary claims), and
- 5 per cent of the proceeds cover court and administrative expenses related to the bankruptcy proceedings.

Only if any funds remain, are these funds included as part of the bankruptcy estate and used to satisfy unsecured claims of 3rd and 4th ranked priority creditors, e.g. claims of unsecured banks.

Pre-sold apartments can be taken out of the estate

Along with the sale of the developer's property, which is the general mechanism used to satisfy creditors' claims under the Bankruptcy Law, in effect, the Amendments permits the contested development to be taken out of the bankruptcy estate and for the apartments to be handed over to the participants. It works in the following way: unfinished apartment blocks – a transfer of the developer's rights to the unfinished apartment block and the underlying land plot to a cooperative (e.g., housing development cooperative) formed by the participants. The cooperative must then finish the construction of the apartment block and transfer relevant apartments to the participants; or, with regard to finished and commissioned apartment blocks – a direct transfer of the titles to the apartments to participants. The previous draft of the Amendments provided the option of handing over to the participants "similar" apartments in other apartment blocks owned by the developer rather than those apartments which were pre-sold to the participants. Were this motion to carry, and if the pre-sold apartment block was not finished, the participants could obtain other apartments in the developer's possession, thus reducing the bankruptcy estate available to other creditors. However, in the current draft of the Amendments this option has been removed, and this change of legislative policy can only be welcomed from the standpoint of non-participant creditors, including banks, whose interests could have suffered otherwise.

However, both options to take the pre-sold apartments out of the estate for the benefit of the participants are not absolute and are possible only if certain quantitative conditions are met. In any case, if the overall value of the participants' claims exceeds the value of the apartments or entitlements handed over to the participants as described earlier, the outstanding part of the participants' claims is then satisfied in accordance with the general provisions of the Bankruptcy Law. So if the participants wish to claim statutory damages under the Participatory Construction Law after the apartments have been handed over to them, these claims will no longer be privileged.

Step in rights

Last but not least, in order to satisfy the quantitative conditions and to handover the apartments or entitlements to the participants, the Amendments allow any third party to step in on behalf of the developer and provide funds sufficient to pay off current operating payments and first and second priority claims.

If adopted, this long-awaited rule will, for the first time, create a viable legal mechanism for local authorities to step in, satisfy prior-ranking claims against the developer and release the property from the bankruptcy estate, which in turn will allow it to be handed over directly to the participants. This is something for which unfortunate clients of failed developers have been clamoring for across Russia for years, only to hear that the authorities are sympathetic but cannot help, even when there is money in the local budget to spend on such an unexpected contingency.

Sadly, for the participants, this tends to be true because the developer is in bankruptcy and there is no legal way to free the contested property from the estate, no matter how much political and administrative will is exercised.

In addition to protecting participants' interests and making protests to their mayors worth while, this law would also help make creditors' councils and bankruptcy proceedings in general less unwieldy and more business-like by reducing the number of individual creditors and eliminating the need to always consider their diverging opinions. The downside, however, might be that a foreign or Moscow bank would find its claims competing with those of the local authorities in a local court, thus running the risk of the local courts being slightly predisposed toward the latter.

Once the prior-ranking claims against the debtor have been satisfied, the third party becomes a third-ranking creditor *pari passu* with the individual participants, thus being put in a more favorable position compared with other creditors, including unsecured banks.

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