

The global downturn is showing signs of affecting the Moscow and Kyiv construction markets, with slight slowdowns of growth in some areas. But while international factors are holding down prices, local demand remains strong (at least for the 3<sup>rd</sup> quarter) and this fact is keeping demand-led labour and service costs high in Moscow.

Raw material prices, including oil, began showing signs of stabilization during the period in question, and with developed markets demand falling, the EMEA pricelists of fit-out materials suppliers saw a slowing of the rate of increase. This affected the Moscow market. Strong demand in Moscow and weakening demand in Kyiv (where base-build construction declined 2.6% in Ukraine and 0.3% in Kyiv year to date) nonetheless led to continuous construction material inflation. The weakening demand in Kyiv is the reflection of financial crunch which caused the delay or cancellation of construction projects as well as the consequences of political complications in the country.

Fit-out material prices, which last quarter saw year-on-year increases of 14.3% and 15.3% respectively in Moscow and Kyiv, saw increases of 13.6% and 19.4% in the 3<sup>rd</sup> quarter.

Key Fit-out Construction Materials	Increase	
	Moscow	Kyiv
Raised floor	4.3	17.3
Carpet	13.8	18.2
Cement	16.7	75.8
Ceramic tiles	14.9	7.6
Double layers gypsum board partitions with insulation	10.0	11.6
Aluminium framed double glazed partitions	21.1	23.1
Double leaf glass door	18.1	11.7
Suspended ceiling	6.4	11.1
Lights Lighting Technologies	29.7	10.0
Floor boxes	1.3	7.8
<b>Average Increase</b>	<b>13.6</b>	<b>19.4</b>

General Contractor Fit-out Works Description	Increase	
	Moscow	Kyiv
Installation of raised floor	13.4	21.3
Installation of carpet tiles	5.7	25.0
Installation of ceramic tiles	8.1	21.0
Installation of double layers gypsum board partitions with insulation	16.0	44.4
Installation of glazed partitions	34.3	28.7
Surface preparation and painting	10.7	21.5
Installation of suspended ceiling Armstrong	20.0	34.7
Installation of lighting fixtures	4.1	7.0
Installation of floor boxes	6.4	16.3
Installation of sockets	10.1	28.8
<b>Average Increase</b>	<b>12.9</b>	<b>24.9</b>

Local fit-out labour costs saw a slight decrease, from 15.0% to 12.9% in Moscow and an increase from 17.7% to 24.9% in Kyiv. While demand is falling in Kyiv, there are also initial signs of softening demand in Moscow, and we feel that this trend will continue over the next 6-8 months.

What softening of demand there is however, is not being reflected in consultant's costs, with prices for architectural and engineering design services continuing their increase. Architectural design in Moscow saw a 17% increase, year on year, in the 2<sup>nd</sup> quarter, and that rate is matched over the 3<sup>rd</sup> quarter. Partially this is due to larger proportion of projects using international rather than local architects.

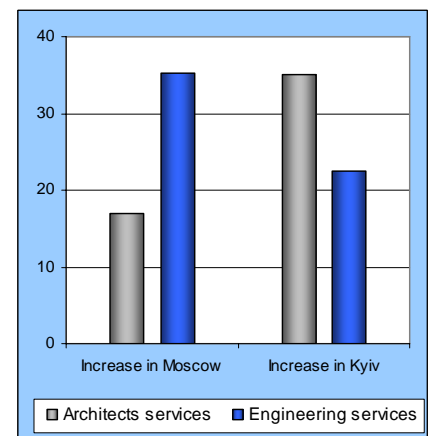
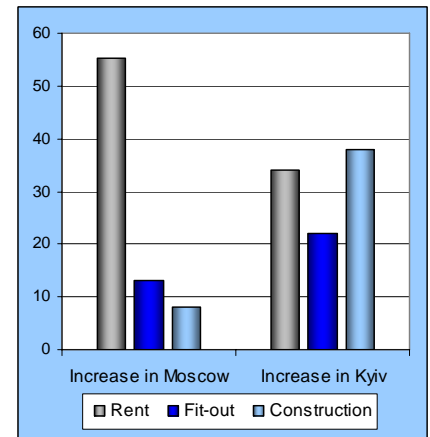
For engineering design, a similar situation pertains, with a 2<sup>nd</sup> quarter increase in Moscow of 36%, reducing slightly to 35% for the 3<sup>rd</sup> quarter.

As indicated in previous bulletins, the cost differential that continues to manifest itself in Moscow between architectural and engineering design (with engineering design inflation running at approximately double that of architectural design) is reversed in Kyiv, with increases of 35% and 23% respectively for architects and engineers. This, as previously identified, is due to the number of mooted, but not developed, projects at Concept stage in Ukraine.

The overall Moscow fit-out cost for the 3<sup>rd</sup> quarter continues to hover over the €690/m<sup>2</sup> mark – increasing to €720/m<sup>2</sup> as an average for Class A space. We predict that, based on services, materials and labour costs projections, this will increase to a ceiling of around €820/m<sup>2</sup> over the next few months before leveling off.

The overall Kyiv fit-out cost for the 3<sup>rd</sup> quarter increased to €617/m<sup>2</sup> average for Class A space. We predict that, based on services, materials and labour costs projections, this will exceed €686/m<sup>2</sup> by the end of the year.

Moscow construction labour inflation continues to outstrip overall local wage inflation by a fifth, with the 3<sup>rd</sup> quarter year-on-year increase 12.9% against



8-10% for the market as a whole. In Kyiv the situation is 24.9% against 6.2% (real) and 35.8% (nominal) correspondingly.

Over average costs are still being paid by some developers and occupants due to the relative lack of good advisors in the market, especially as concerns cost control. Fixed price contracts, value engineering as a key stage in the design process, and even competitive tendering are still not universally utilized, leading to significant avoidable costs. This neglect, typically mainly of bull markets, can be expected to decline as the market stabilizes, but has led in the past 12 months to fees as high as €185/m for architectural and engineering design and fit-out costs as high as €9 600/m<sup>2</sup> in the financial services sector in Moscow.

*All figures relate to annualized percentage increases in the specified market segments during the third quarter of 2008. All figures are based on vendor quotations received from a mix of international and local vendors during this time period for completion during 2008. We have not discounted contractor hedging for this time period. All figures relate to contractor bid prices, not manufacturers list prices, and therefore represent the real end-user cost.*