Russia still speaks a different language

JIM PICKARD

Russia has always been an almost universal no-no on the European property investment map. And with just reason. For all the talk of a post-Soviet democracy which would be ever more liberal and progressive, few would argue that this is the case today.

The Chechen war, a poor human rights record, widespread corruption: no wonder property investors have shied away.

Consider Yukos, where founder Mikhail Khodorkovsky saw his wealth confiscated and his freedom curtailed. Or Royal Dutch/Shell, which saw its Sakhalin-2 deal undermined last year.

Or take the withdrawal of a visa from Bill Browder of Hermitage Capital.

Politically, the idea that Russia would gradually move towards the west under president Vladimir Putin, a former KGB spy, is no longer credible.

A string of events - including the unsolved murder in London of former KGB agent Alexander Litvinenko - have raised western suspicions. So has the Kremlin's strong-arming of smaller neighbours over energy.

If you think this impression is overcooked, you should buy or borrow *Putin's Russia*, a damning indictment by Anna Politkovskaya, formerly the country's leading investigative journalist. I say former, because she was shot dead last October by person or persons unknown. Political and business murders are not uncommon in modern-day Russia.

The book will give you a contrary impression to the reassuring mood music made elsewhere - at a time when enthusiasm for Russia is growing within international investment circles including property.

The country is seen as a demographic and economic growth story, along with Brazil, India and China.

A fast-growing middle class could have a positive impact on property demand and - potentially - political governance, says Paul Kennedy, head of European research at Invesco.

Retailers including Carrefour and Metro, Wal-Mart and Tesco.are all mulling plans to open hypermarkets. The Economist Intelligence Unit expects total retail sales to double from 2005 to 2010 from $245bn to $526bn. Demand for offices and warehouses could grow as more multinationals set up base. The number of international property players looking east has accelerated. Only two years ago, they were few and far between. Some €3.07bn was invested in Russian property during 2006, according to Cushman & Wakefield, up 222 per cent on 2005.

But perceptions changed with the successful flotation of Raven Russia, a development group targeting the warehouse sector. Raven, which floated at a value of £153m, raised £310m through a rights issue soon after.

American and British groups now looking to invest in Russia include AIG Global Real Estate, GE, JER, Invesco and banks such as Morgan Stanley and Goldman Sachs.

European real estate companies entering Russia include Rodamco Europe of The Netherlands and Trigranit of Hungary.

Russia accounted for 9.4 per cent of international investment in central and east Europe last year, according to CB Richard Ellis, the global property adviser, against just 4 per cent in 2005.

Russia has no land registry, and plot documentation starts from 1992

The debt options for international investors have also widened since Eurohypo and Hypo both began lending in Russia. If they are followed by other lenders it could make it even cheaper to borrow. Loan-to-value ratios may also rise from typical levels of about 75 per cent.

But before buying in St Petersburg or Moscow, remember several points.

First, the political situation. Further uncertainty hangs over the country with the expected transition from Putin's (fiscally prudent) government next year. Buoyant GDP forecasts are highly dependent on revenues from a strong oil price.

Second, the dynamics of property supply and demand are harder to call than anywhere else in Europe. Sure, there is a desperate need for new office and retail in the main cities. But local developers are already hard at work producing new buildings. Will demand increase fast enough to sustain that?

Third, there are property-specific headaches awaiting investors. Russia has no land registry, and the documentation covering land plots only dates back to 1992. You cannot buy freehold. Some investors get around this by avoiding development and only buying completed stock; preferably with western tenants. But more buyers in Russia are getting involved earlier in the supply chain; which means development with a local partner.

That seemingly arbitrary judgment could be the one upon which your venture succeeds or founders.

Meanwhile, the Moscow authorities are considering intervention in the city's residential property development market amid suggestions of price-fixing.

Bullish forecasters are predicting that Russian yields - still in the double digits - will be forced downwards in the same way as central and eastern Europe.

But much of that trend stemmed from the "convergence" story as countries joined the European Union.

Russia shows little sign of moving in the same direction.

Fonte: Financial Times, USA, 20 Feb. 2007. Special Report Property, p.9.