

Savvy real estate investors have uncovered a well-kept secret — pre-Revolutionary buildings generate higher rental returns than sleek modern developments.

In the rental market, location is everything. Whether the building is more centrally located matters more than what type of construction it is.

As the visible remnants of Tsarist Russia's charm, buildings constructed before 1917 are especially popular with foreign tenants. In addition to the historic significance of these buildings, the vast majority of them are located in the city center, home to Moscow's most prestigious districts. And pre-Revolutionary buildings have proven to generate the highest rental returns, compared with other housing, including modern developments built after 1990.

One square meter of property in a pre-Revolutionary building cost roughly \$1,500 in 2001, the same as a square meter of property in a high-quality, Stalin-era building in the city center. Four years later, many pre-Revolutionary, historic properties have appreciated three to four times the original investment amount, reaching \$3,000 to \$7,000 per square meter, depending on the location.

In contrast, one square meter of a newly constructed building grew from \$3,000 to \$8,000 in 2001 to \$5,000 to \$15,000 in 2005. This is, of course, a significant growth in monetary terms. However, compared with historic buildings, it is only 50 to 100 percent appreciation in value.

As for today's rental rates in the same

Historic Properties Make Good Investment Sense

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location, apartments in modern buildings with underground garages, fitness centers and other extra amenities are rented with only a 20 to 30 percent premium over historic buildings. As a result, the rental returns from new buildings are lower because the premium in rental price does not justify the much higher (around 100 percent) per-square-meter cost of modern buildings.

For example, a 2-room apartment with a total area of 70 square meters in an historic building, at an investment price of \$4,000 per square meter, yields \$2,500 in monthly rental rates. In contrast, an apartment of the same size in a modern building costs \$8,000 per square meter and yields \$4,000 in rental rates. Therefore, a 2-room pre-Revolutionary property earns rental returns of 10.7 percent, compared with an 8.6 percent return brought in from renting out a modern property.

From the client's practical and economic point of view, it often makes more sense to rent a pre-Revolutionary property. Normally, corporations allocate housing budgets, according to the functional use of an apartment and its ability to match the needs of the client. The employer and most tenants consider the number of bedrooms and the location of the property to be a priority. Underground parking and a health center in a building is no doubt a plus. However, with rental prices sky high and already on par with most world capitals, the market can barely support even higher prices.

Another important consideration is the size of a property. While large corporations are increasingly hiring locals for middle management, the base clientele for the



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mid- to upper-range rental market, senior executives are still mainly foreigners, and they generally have a taste for spacious apartments and housing with an area of more than 150 square meters. Housing of this size still remains scarce and it presents a valuable opportunity for investors. Larger apartments always make high annual returns from leasing. For example, an investment of \$4,000 per square meter of space could yield \$1,500 in monthly rent from a 50 square meter, 2-room apartment, or \$6,000 per month from a 150 square meter 5-room apartment. Therefore, the return from a 5-room apartment is 6 percentage points higher than the return from a 2-room apartment.

Although the overall growth of the rental market has been slower than the sales market over the last five years — residential sale prices have tripled compared with average rental rates growing between 30 and 40 percent over the same period — buying to lease still makes sense. Investors in rental properties capitalize on the annual appreciation, as well as rental returns, which still range between 7 and 15 percent per year.

On a cautionary note, when buying any type of property, it is important to research City Hall's development plans. Any investment scheme, no matter how grand, can be cut short by government-led bulldozers. Many of Moscow's older buildings are earmarked for demolition to make way for modern developments. The owners of properties that will be torn down only get compensated for the amount of their original investment. At the same time, the attractiveness of a modern development also decreases if a construction site pops up next door. Therefore, up-to-date information is a key factor when investing in Moscow real estate so as to come out on top.

It is tough to make assertions about future trends, since political and economic risks will always affect property prices. Any savvy investor should consider whether political risks, such as the Kremlin's recent campaign to centralize power in Russia, or economic weaknesses, stemming from the country's dependence on high oil prices, are tolerable.

However, with the risks come the rewards. With some properties showing quadruple returns since 2001, betting on Russia is difficult to resist.



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Pre-Revolutionary rental properties bring in returns of 10.7%, compared with 8.6% from modern buildings.