VIEWPOINT
BALTIC RESIDENTIAL

Investors are Showing Interest in the Baltic Multi-family Sector

Multifamily residential properties bought by BTA Insurance in Riga.
Source: CBRE Baltics, 2021.

The multi-family sector has been a hot topic in almost every European country for the past few years. The main catalysts for this elevated interest is the growing awareness of ongoing urbanization, especially in the CEE region. People tend to move across Europe in search of higher salaries, social benefits, better living conditions and other quality life well-being factors. For example, we can see that technological development, in sectors such as agriculture and manufacturing, is rapidly pushing people out of jobs, leaving no other option than to move.

From an investor perspective, multi-family assets usually carry lower risks than other asset classes. By acquiring this type of asset, investors aim to diversify their portfolios, due to low correlation with other commercial real estate sectors. Overall, vacancy is lower due to the scattered tenant profile, and usually long-term inflation linked returns.

The ongoing pandemic has affected the daily operation of a wide range of commercial real estate sectors. At the same time, we can see that overall investor interest is remaining stable and, in some cases, even growing. One of these sectors is the market for multi-family rental buildings. Demand in this sector is less affected, especially during a time when most people across the globe are being advised to stay home.

URBANIZATION AS A DRIVING FORCE

The roots of the multi-family rental market lead us back into the history of all the Baltic capitals, when the cities, as we know them today, were just developing. If we were to walk around for example Riga city centre, we could see that some of the buildings that were built in the early 20th century, were constructed mainly by local developers as rental properties, to accumulate the bubbling demand from rural residents moving to Riga. We are seeing similar trends now, as major cities attract people through offering them better social and economic benefits, education, professional development opportunities, better life quality, etc. Of course, there is already a high level of demand for rental apartments, and it is anticipated that demand will also continue rising in the future. According to Oxford Economics, around 30% to 50% of the population already lives in or near the Baltic capital cities in the respective countries. In 2018, the United Nations published a paper on Urban and Rural populations which estimated that ca. 80% of the global population will already be living in urban areas by 2050. This means that there will be growing demand for rental apartments in the foreseeable future.

Multifamily sector SWOT analysis from the investor point of view, 2020/2021

STRENGTHS	WEAKNESSES
• Long-term inflation linked returns • Reduced vacancy risks • Stable income stream • Resilience to variably in the use of premises • Tenants prioritizing rent payments	• Higher maintenance and management costs • Lower yields • Ununified legal and tax systems across the different legislations
OPPORTUNITIES	**THREATS**
• Portfolio diversification • Urbanization – growing demand • Lack of modern developments across the Baltic capitals • Growing economy and purchasing power	• High competition in coming years • Some landlords may put pressure on rental rates in order to stay competitive • Increasing construction costs

Source: CBRE Baltics, 2021.

SHORTAGE OF MODERN SUPPLY – NICHE FOR DEVELOPERS

Few newly built multi-family residential buildings have been delivered across the Baltics in the past 10 years thus, the market sector in Baltics is still underdeveloped. This is about to change, however, as several pan-Baltic investors and developers have not only expressed their interest in the sector publicly, but have also commenced the development process. In 2020, Eften, Scandium, Lumi Capital, Hepsor, Kaamos, Vastint, and others have started exploring the sector, with the Lindenholm, Z-Towers, and Philosophers Residence developments in Riga; the K9A, Live-in, and Solo Society in Vilnius, and the Kadaka, Newton Stuudios and Aiandi in Tallinn. The delivery of these new units in the market will definitely change the overall understanding of rental apartments, offering tenants higher quality service at a comparable price. It is possible that secondary assets will lose their attractiveness from a tenant point of view, when the rent prices offered are at the same level.

Existing supply doesn't correspond to growing expectations.

The current stock of multi-family rental apartments across the Baltics is similar and consists mainly of two types of assets. Old rental buildings located close to, or in the city centres, usually owned and operated by local investors. Although most of the multi-family stock has been established by individuals who own one, two, three and sometimes more rental apartments, they are usually poorly managed and scattered within different buildings across the cities. These individuals have a higher expectation of investment returns, compared to institutional landlords.

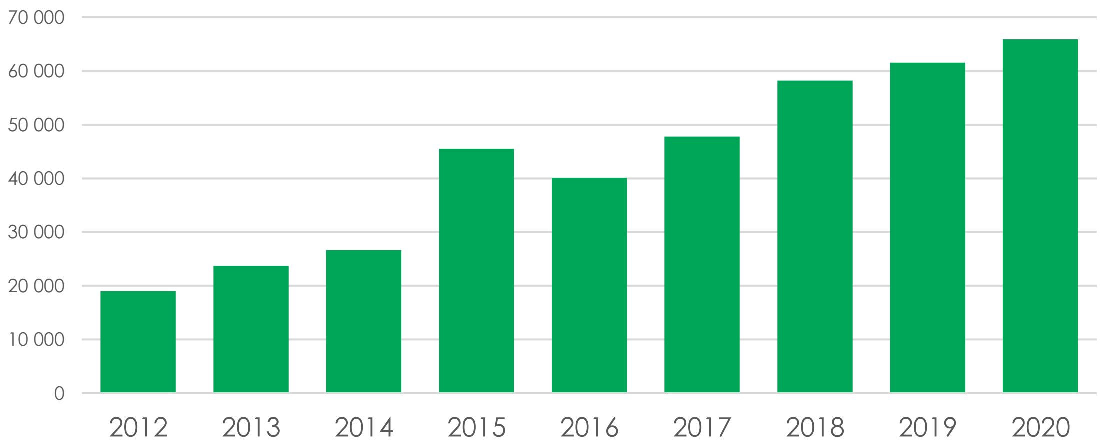
There are few examples of newly developed multi-family buildings in each of Baltics capitals, that represents the new trend of rental sector. In Riga there is newly built rental building located in city centre Cesu Terases. Development is fully leased and has tenant waiting list carrying low overall vacancy risks. In Vilnius K9A multi-family building with 71 apartments were delivered in 2020, fully leased in few months. Capitals Manufaktuuri quarter in Tallinn, with 127 rental apartments were delivered in 2019, now almost fully leased, with rent rates at the market level. Low vacancy, quick absorption, stable rental income and rather small competition are just few elements for investors and developer satisfaction. As a result investment returns in prime multifamily rental assets are evident at 5.00% – 5.50%.

THE MULTI-FAMILY MARKET IN EUROPE

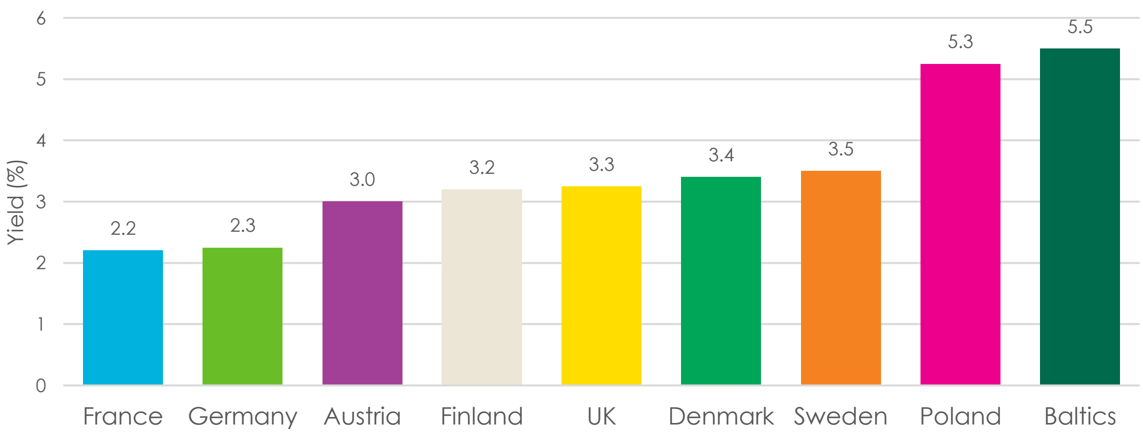
The situation in Europe is comparable to the Baltic region, as the stable rent profile of rental properties has been the main reason behind the rising volume of investor enquiries. This is the case, not only for mature multi-family markets in Central Europe or Northern Europe, but also for emerging multi-family markets in Southern and Eastern Europe.

Major European private housing companies and some fund managers are currently looking for ways to increase their market shares, while expanding in different or new market segments. The Baltic Capitals could be an appealing location for an increasing European capital investments, if there was a sizeable opportunity for them – ready development or even a portfolio of developments for them to acquire.

Residential investment volumes, in Europe, mEUR, 2012 - 2020



Residential yields, prime capital city, Q1 2021



Source: CBRE Baltics, 2021.

PAN-BALTIC MULTI-FAMILY OUTLOOK

Despite the challenges that we are facing on the macro level today due to COVID-19 restrictions, the outlook for the multi-family sector is positive. Some developments have already been delivered and are performing well, while others will follow in the upcoming years. We have witnessed a couple of sizeable multi-family asset transactions across the Baltics, and with investor confidence still growing, we know that this sector is here to stay, as competition in the sector is still low.

Rent rates in Baltic capitals faced a minor decrease during 2020, however, quite a quick recovery is expected in 2021, when rents, especially in city centres, will continue to grow.

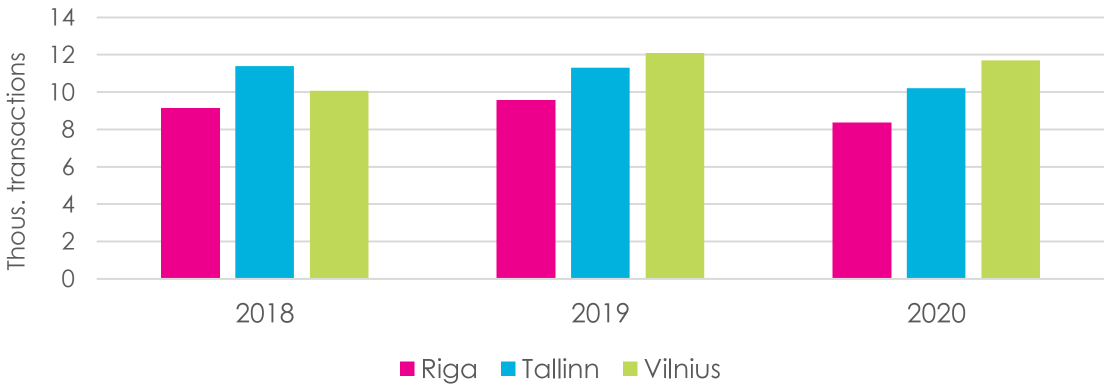
European investment volumes in the multi-family sector have grown from EUR 23bln in 2013 to EUR 65bln in 2020, clearly showing investor confidence.

THE RESIDENTIAL MARKET IN THE BALTICS

After one year of the pandemic, the residential market has performed well, despite the first shock wave. CBRE Baltics have noted that the overall number of transactions decreased in the early summer of 2020, although there was a short recovery period and even outperformed 2019 results during Q4 2020, especially in the new development sector. In total, an 8% decrease in transactions was noted in the residential apartment sector, with the highest decrease in Riga of ca. 12% and the lowest decrease in Vilnius, with just ca. 3%. In terms of pricing, it is evident, that apartment prices have increased on average by 3% to 5%, although buyers spent up to 8% more on apartment acquisition than in 2019 on apartments. Average single transaction volume is growing faster than overall apartment prices, and one of the main reasons is the growing new development market. Overall, across the Baltics, the share of apartments sold in buildings built in the last 20 years, has grown up to 28%.

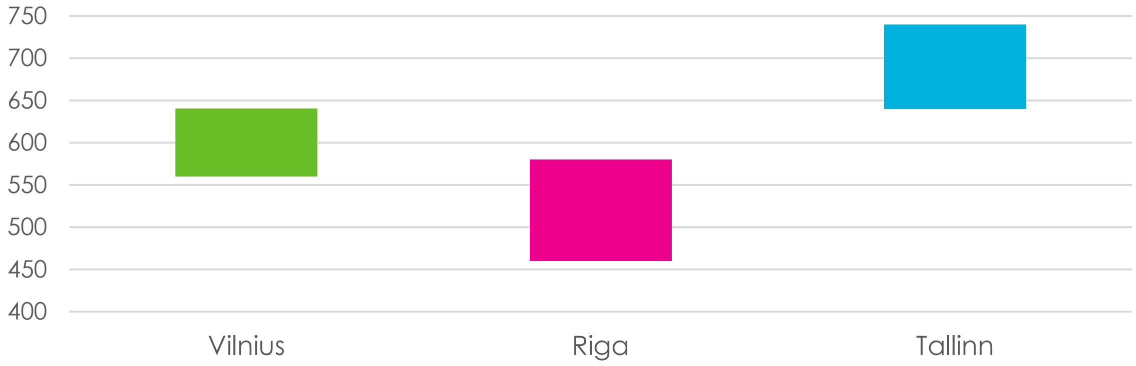
In terms of demand, we can see that overall in the Baltic countries it remains balanced, however slightly higher in Vilnius and Tallinn.

Number of apartment sales transaction, 2018 - 2020



Source: CBRE Baltics, 2021.

Average 45 sqm apartment rent rate in the city centre



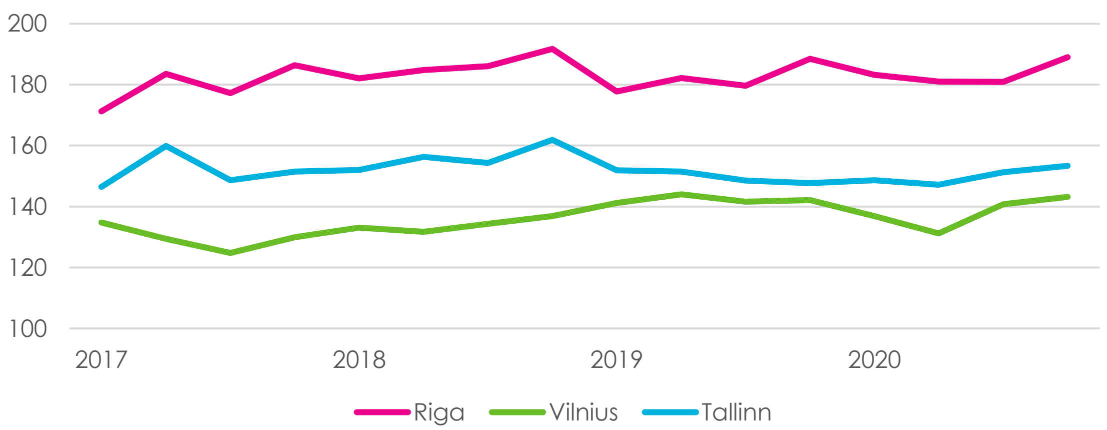
Source: CBRE Baltics, 2021.

In 2020, apartment rents in capital cities remained stable, with a minor decrease in city centre apartments, due to a lack of tourists, while some short-term rental apartments were turned into long-term schemes. CBRE Baltics have noted upward pressure in the economy sector, due to apartment price increases and a lack of quality products available in the market.

In terms of potential buyer sentiment, we have seen a positive trend in the market already, that may indicate long-term sector growth. The main driving force for growth will be elevated personal savings, which have increased during this year «spent at home», financial institution readiness to issue low interest loans, and overall apartment availability, especially in Lithuania and Estonia, where the construction pace has been high for the past 4 years.

According to Swedbank's housing affordability index, a quick recovery has been seen after a steep drop at the beginning of 2020. At the end of 2020, Riga is still leading the Baltics with the highest affordability, followed by Tallinn and Vilnius respectively.

Baltic housing affordability index, 2020



Source: Swedbank, 2021.

RESEARCH DEFINITIONS

SELLERS' MARKET - a market situation where sellers are outnumbered by buyers by a big margin and the quantity of income generating commercial properties available for sale becomes far less than the quantity demanded. As a result, sellers are able to increase prices and obtain better sale conditions and the situation becomes favourable for sellers.

PRIME YIELD – represents the net yield that an investor would receive when acquiring a class A building in a prime location (for an office in the CBD, for example), which is fully let at current market value rents. Prime Yield should reflect the level at which relevant transactions are being completed in the market at the time but need not be exactly identical to any of them, particularly if deal flow is very limited or made up of unusual one-off deals. If there are no relevant transactions during the survey period, a hypothetical yield should be quoted, and is not a calculation based on particular transactions, but it is an expert opinion formed in the light of market conditions, but the same criteria on building location and specification still apply.

TRANSACTION COUNT – the number of single apartment transactions in the Baltic region during the research period. The transaction count may differ if counted for each country separately - in that case a portfolio transaction could be divided by the number of properties located in each country.

Housing Affordability Index – is a number calculated for a family whose income is equal to 1.5 of average net wages with an average-sized apartment of 55 square meters. The HAI is 100 when households use 30% of their net wages for mortgage costs. When the HAI is at least 100, households can afford their housing, according to the established norm. The higher the index, the greater the affordability. (Swedbank, 2020)

ABOUT CBRE BALTICS

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Providing services in:

- Research & Analysis,
- Consulting,
- Valuation,
- Property Sales,
- Property & Asset Management,
- Tenant Representation,
- Agency Services – Retail, Offices, Industrial & Logistics,
- Financial Services, Accountancy,
- Landlord/Investor Representation,
- Transaction Management.

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