MARKETVIEW
VILNIUS OFFICES, H1 2021

CBRE Baltics
Part of the CBRE affiliate Network

Approaching the end of the office downturn

Office Stock	Completions	Vacancy	Office Take-up	Stock under construction
866,000 sqm	76,000 sqm	10.9%	45,000 sqm	225,000 sqm

*Arrows indicate change compared to H1 2020

Figure 1: Nova by Technopolis – one of the most sizeable office projects in H1 2021

Credit: Norbert Tukaj, 2021.

KEY POINTS

- The first half of 2021 brought six modern office projects which added 76,000 sqm to the total Vilnius office stock, representing over 2.2 times more space compared to H1 2020.
- The supply of modern office is expected to increase by ca. 57,000 sqm by the end of the year, reaching the highest recorded development volumes ever observed in the market.
- Currently, A-class offices constitute 44%, while the remaining 56% of total stock is made up of B-class.
- In H1 2021, modern office take-up constituted ca. 45,000 sqm, which was 9% up compared to a year ago. However, take-up remained impacted by viable remote working, downsizing, and optimization of offices.
- IT and technology sector companies, which were relatively mildly affected by the pandemic, demanded the most office space, constituting 27% and 24% of the total take-up, respectively.
- The vacancy rate stood at 10.9% which is more than 2.4 times up than a year ago. The vacancy rate is expected to remain in double digits with increasing market supply.
- Rental levels faced slight changes. The rent for B-class office premises stayed between 10.0 – 14.0 EUR/sqm/month, while for a typical A-class office it was between 15.0 – 17.0 EUR/sqm/month.
- Office investments in Lithuania amounted to almost EUR 28 mln. Prime office yields were recorded at 5.25% in Q2 2021.

ECONOMIC OUTLOOK

As the vaccination volumes increased, the market observed a gradual comeback to lively economic activities. Fiscal support and a timely reaction to the virus spread contributed to the rebound of the economy in Lithuania. However, uncertainty remains high, and, consequently, household discretionary spending is still conservative.

According to Oxford Economics, the real GDP per capita in 2020 stood at EUR 30,998, reflecting a decrease of only 1% on a y/y basis. The real GDP of the country is projected to increase by 3.7% in 2021. These metrics signify the solid economic recovery in the country driven by the robust performance in the technology, ICT, industrial, and finance sectors. Yet, the economic recovery path in 2021 will highly depend on virus containment measures.

Inflation in Lithuania is mainly impacted by a long-term trend caused by economic integration and convergence to the EU. Inflation is expected to move upwards in tandem with the revival of economic activity. According to Oxford Economics, average annual inflation stood at 1.2% in 2020. Higher inflation (of 2.5% in 2021 and 2.4% in 2022) is anticipated, as energy prices are forecasted to pick up from a drop in 2020, together with wage growth and the gradual recovery of domestic demand.

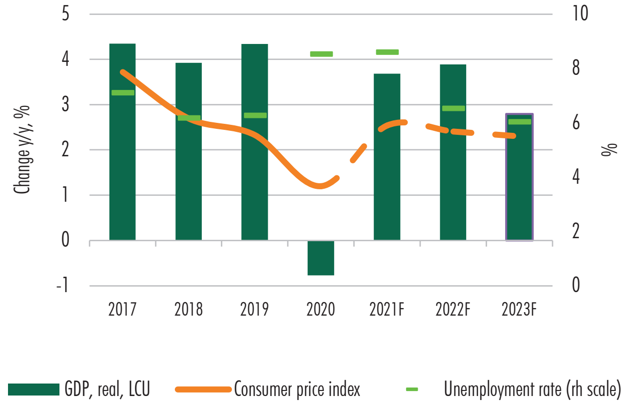
Net migration was positive in 2020. Yet, the unemployment rate rose from 6.3% in 2019 to 8.5% by the end of 2020 in light of the Covid-19 pandemic. However, the rebound of economic activity should gradually bring the unemployment rate down to 8.4% and 6.5% in 2021 and 2022, respectively, according to Oxford Economics' predictions.

According to Lithuania's Statistics Department, overall exports fell by ca. 3%, while imports decreased more significantly by almost 9% in 2020 on a y/y basis. The relative resilience of exports reflects the comparatively stable external demand for Lithuania's lower value-added export goods and humble dependence on tourism. In addition, timely virus containment measures at the beginning of the pandemic also helped the economy.

SUPPLY

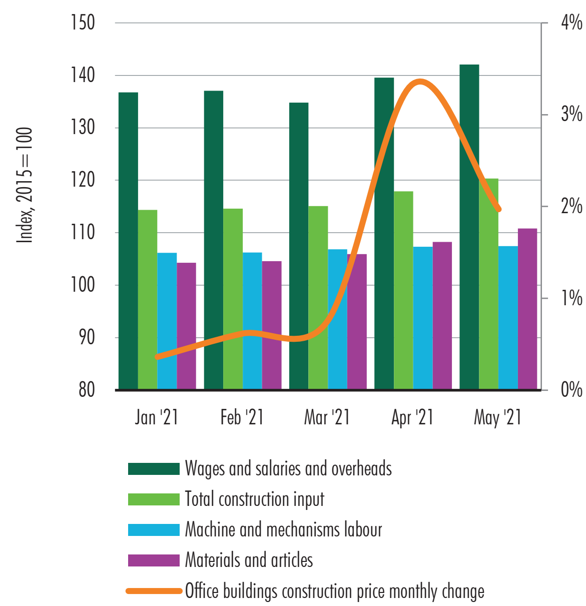
The downsizing and lease terminations of sizeable market players have not significantly altered the plans of developers to proceed with the offices' development pipeline. Although the remote work model is still viable and a hybrid working principle is

Figure 2: GDP growth, inflation, and unemployment rate



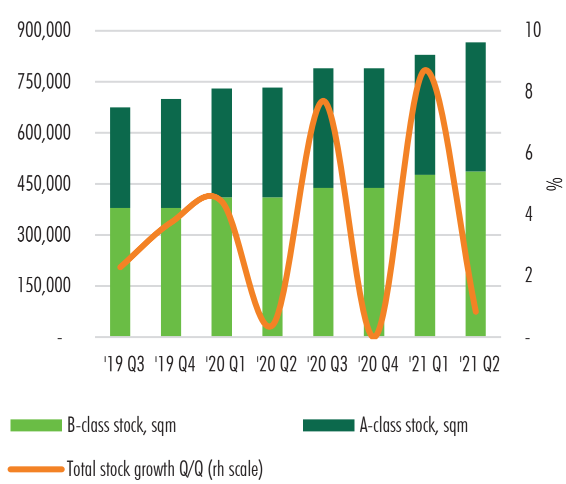
Source: Oxford Economics, CBRE Baltics, 2021.

Figure 3: Construction price index



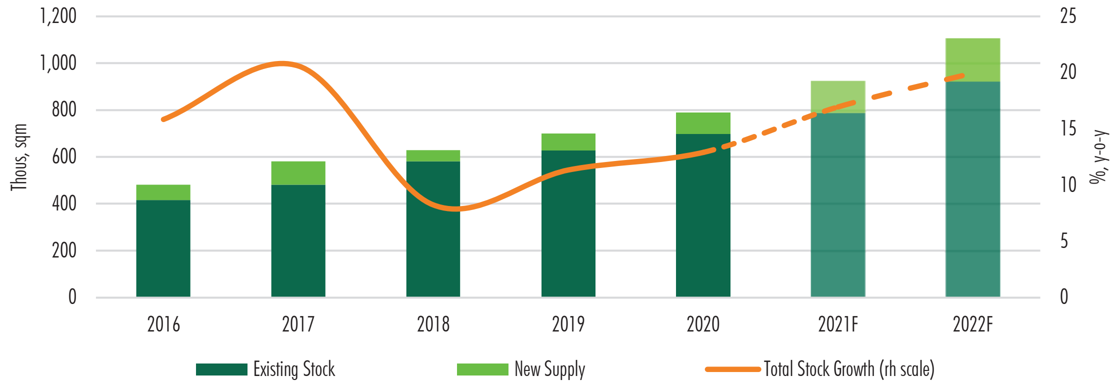
Source: Lithuania's Statistics Department, CBRE Baltics, 2021.

Figure 4: Quarterly breakdown of total stock



Source: CBRE Baltics, 2021.

Figure 5: Modern stock, new supply and stock growth rate 2016 – 2020 with forecast for 2021F-2022F



Note: the end of the indicated year.
Forecast is based on announced completion dates of the planned projects.
Source: CBRE Baltics, 2021.

putting severe pressure on sizeable office lease transactions, the overall sentiment in the market remains positive as the vaccination process successfully progresses. Over H1 2021, the overall office stock reached 866,000 sqm, constituting an 18% growth rate compared to the total supply in H1 2020. The market is expanding at an unprecedented pace, with ca. 225,000 sqm currently being under construction and significant volumes in the initial or pre-final planning stages. The commissioning volumes reaching ca. 76,000 sqm in H1 2021 and anticipated delivery of another ca. 57,000 sqm in H2 2021 is expected to set the new record for the leasable office space deliveries, signifying a booming supply in the city.

The most sizeable delivery in H1 2021 belonged to the commissioning of *Nova Business Center*, by *Technopolis*. The B-class business center brought ca. 26,500 sqm of leasable area to the market. Another significant in size project delivered in Q2 2021 is an A-class *Lvovo* business center by *Lords LB*. This project supplemented the office stock by approximately 15,000 sqm of leasable space. Overall, six new business centers were delivered to the market throughout the first semester.

The office space under construction may suffer from the recent increase in construction costs due to the booming residential market in the city. According to the Lithuania Statistics Department, the construction input prices for office buildings rose by 7.2% in May 2021 compared to December 2020. It is predicted that by the end of Q2 2021, there might have been a higher than 10% increase in the prices of construction materials. Overall construction costs are expected to continue increasing further due to the lively global business environment as vaccination volumes increase.

In Vilnius, developers and landlords mainly compete on modern business center's solutions, which help to get tenants' attention and negotiate substantial lease transactions. Thus, the market implies that with the culminating growth of administrative stock, the Vilnius office market will start leaning towards complete absorption of A-class stock, which currently forms 44% of the market. In contrast, the B-class stock will continue attracting relatively more price-sensitive market players.

Sustainability is becoming a primary consideration worldwide, and Vilnius commercial real estate goes hand in hand with this tendency. Therefore, certifications are becoming not only a trend, but also a competitive advantage, which based on Vilnius city municipality announcements, will become a must-have for all buildings above 5,000 sqm in the years to come. Today in Vilnius, ca. 404,000 sqm of modern office stock is certified, out of which around 30% is LEED and 70% is BREEAM certified. The first WELL certified building in Vilnius is expected to appear in the market in 2023 with the delivery of project Hero, while the Core Business Center aiming for Fitwel certification is announced to be in the market already in 2022.

DEMAND

In contrast to what was predicted, the demand side of the Vilnius office market showed its resilience to pandemic uncertainty and was exceptionally lively. The main activity remained relocation of existing companies, yet quite a few new entrants have also appeared among the market players. Overall, the take-up constituted ca. 45,000 sqm in H1 2021 which reflects a 9% increase as opposed to H1 2020.

On average, throughout the past three years, around 70% of the most sizeable lease transactions took place in the newly commissioned business centers. This reflects the quick absorption of the new stock and increasing vacancies in relatively older office buildings. Most of the sizeable lease transactions in H1 2021 were among IT (27%) and technologies (24%) companies.

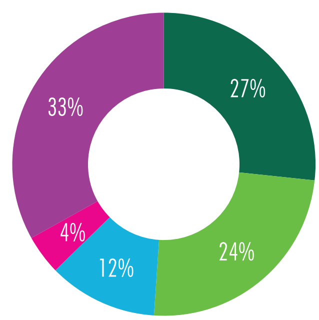
Throughout the first half of the year, the most significant lease transaction belonged to the healthcare technologies corporation *Dexcom*. It pre-leased around 6,000 sqm and became the anchor tenant in the *Business Stadium North East* business center development. The take-up was also exceptionally driven by Belarusian companies' appearance in Vilnius. Belarus-based online video games developer and publisher *Wargaming* has leased almost 5,000 sqm in the *Quadrum* business center and intends to occupy the leased area in stages. The FinTech companies and real estate enterprises have already observed an increase in Belarusians' settling in Lithuania as more accounts have been opened and more people are looking for rental homes. This signals an opportunity for the office market, as well.

Viable market activity could well be observed throughout the intensifying traffic jams during the rush hours in the city. However, the milestone of the massive comeback to offices is yet to be achieved with the increasing volumes of vaccination in the city. Yet, the recently released National Certificate notifying that a person who has a Covid-19 negative test has been vaccinated or has recovered from the virus has contributed significantly to the safe well-being in offices. In addition, the release of the European Green Passport may also contribute to cross-border business travel.

Yet, the recent public announcements of such private corporations as *Vinted* or *Tesonet* and public organizations like *Vilniaus Silumos Tinklai* suggest that hybrid work is likely to stay. The so-called *workation* initiative has also become an essential consideration on many companies' agenda, which is expected to help retain and attract a quality workforce. Remote work is likely to contribute to building virtual work teams, which could help hire qualified people irrespective of their physical location. Yet, many specialists outline that working remotely might not be sustainable due to the lack of interaction among employees.

Non-typical situations require a search for innovative solutions. The pandemic shaped working environment has also made developers approach the remote working trend creatively. *Darnu Group* has recently announced *Nebiuras* project, which aims to establish creative workspaces in the fresh air nearby Baltasis Bridge in Vilnius CBD. The project is expected to be released in Q3 2021 and provide single as well as teamwork spaces with sun-generated electricity stations and Wi-Fi connections.

Figure 6: Take-up by sector in H1 2021



Source: CBRE Baltics, 2021.

Figure 7: Projects completed in H1 2021

No.	Project	Street	Landlord	Quarter of completion	Class	GLA, sqm
1	Lvovo 37	Lvovo	Lords LB	Q2	A	15,160
2	S7 IV	Saltoniskiu	Galio Group	Q2	A	12,500
3	Nova	Vito Gerulaicio	Technopolis	Q1	B	26,470
4	Business Garden (part of I stage)	Laisves	Vastint	Q1	B	10,000
5	Office 100	Naugarduko	Skraidenis	Q2	B	9,500
6	Seskines Sodai	Seskines sodu	Buvis	Q1	B	2,400
					Total	**76,030**

Source: CBRE Baltics, 2021

VACANCY

As of Q2 2021, the vacancy level stood at 10.9% in the Vilnius office market. This constitutes around a 2.4 times increase compared to Q2 2020. The metric is mainly driven by the B-class stock (13.1%) figures. While the modern newly commissioned stock is quickly consumed by international corporations that demand quality wellness solutions, older business centres' owners attract more price-sensitive market segments. Yet, in the light of pandemic uncertainty, potential occupiers, especially from the pandemic-fragile sectors, prefer flexible lease terms and are afraid to enter long-term contracts. It implies that traditional offices may face harsher competition with the co-working and small serviced offices segment. Thus, the office market may notice gradually rising vacancy in the short to medium term.

MARKET RENTS

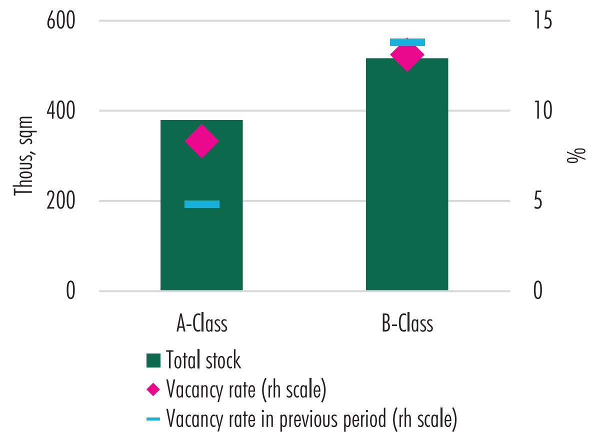
Market rents experienced only a slight change in values. While the B-class office premises range remained stable between 10.0 – 14.0 EUR/sqm/month, A-class prices rose to the level of 15.0 – 17.0 EUR/sqm/month. There are no major fluctuations in office rents in the Vilnius market, primarily due to abundant supply and pandemic uncertainty. However, prices might climb up in the near future, especially in the newly commissioned buildings, due to the increasing construction costs in the market.

INVESTMENT & TRANSACTIONS

Capital markets in the offices' segments have shown only a few but relatively substantial deals. The overall office investment volume in Lithuania constituted ca. EUR 28 mln in H1 2021, which represents only 12% of office investments in H1 2020. More than 80% of the office investment value was generated in Vilnius.

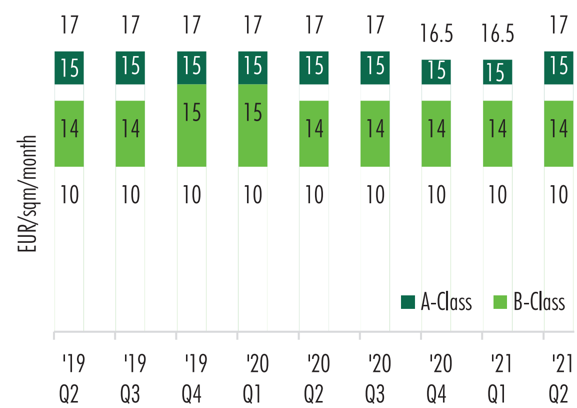
The most substantial transaction in H1 2021 concerns Swedish investment company *Eastnine* that purchased two office buildings in the Baltics from international real estate company *Vastint* – one of which is the prime LEED-certified *Uniq Business Center* in Vilnius central area commissioned in 2016. The business center has *Danske Bank* as the anchor tenant, which generates reliable rental cashflows for the building annually.

Figure 8: Vacancy rate by office class



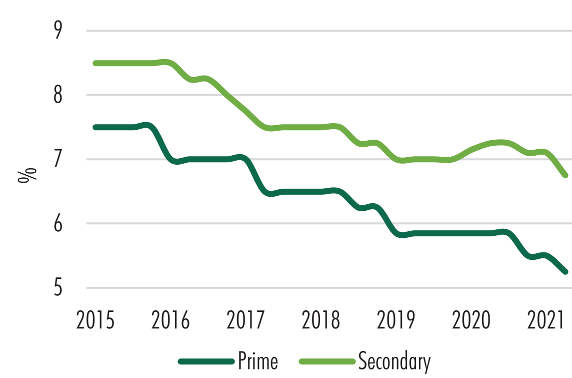
Source: CBRE Baltics, 2021.

Figure 9: Rent price ranges by office class



Source: CBRE Baltics, 2021.

Figure 10: Office investment yields



Source: CBRE Baltics, 2021.

The prime yield in the Vilnius office market has become more robust and reached the level of 5.25% as of June 2021, representing a decrease of 60 bp compared to the corresponding period in 2020. The secondary office yield has also observed a strong sentiment and firmly settled at 6.75% at the end of Q2 2021. This signifies that Vilnius is recognized as an appealing office investment environment in the Baltic States and throughout CEE countries.

RESEARCH DEFINITIONS

Total Modern Stock – represents the total completed class A and B space (occupied or vacant) in the private and public sector at the survey date. Includes owner occupied (OO) space.

Vacant Space – represents the total net rentable floor space in existing properties, which is physically vacant and being actively marketed as at the survey date.

Vacancy Rate - represents the percentage ratio of total Vacant Space to Modern Total Stock.

Take-Up – represents the total floor space, including known to have been pre-let, sold or pre-sold to tenants or owner-occupiers during the survey period.

Prime Rent – represents the top open-market tier of rent that could be expected for a unit of standard size (commensurate with demand in each location) of the highest quality and specification and the best location in a market at the survey date. The Prime Rent should reflect the level at which relevant transactions are being completed in the market at the time. If there are no relevant transactions during the survey period, the quoted figure will be more hypothetical, based on an expert opinion of market conditions.

Absorption – represents the change in occupied stock within a market during the survey period.

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