MARKETVIEW
RIGA OFFICES, H1 2021

CBRE Baltics
Part of the CBRE affiliate Network

Office spaces being adapted to new ways of working

Total Modern Stock	Vacancy	Take-up	Completions	Prime yield
739,000 sqm	**12.8%**	**17,500 sqm**	**0 sqm**	**5.5%**

*Arrows indicate change from H1 2020

Figure 1: Zeiss Offices visualization

Source: Mukusalas Biznesa Centrs, 2021.

KEY POINTS

- The impact of the pandemics on the Latvian economy was less than expected on account of favourable financial conditions, government support and various economic agents and the economy is expected to upsurge in the next few years.
- Around 200,000 sqm (almost 1/3 of existing stock) of modern office premises are planned to be developed in Riga in the next 3 years.
- SEB Global Services announced their relocation to the Galio Group office building *Gustavs*, which is currently under construction, leasing ca. 11,000 sqm.
- The Baltic RE Group renovation project in the city centre, *The Icon* - the biggest modern stock delivery this year, ca. 3,000 sqm was pre-leased by Printful.
- Rent levels remain stable, in A-class office buildings standing at 14.00 – 17.00 EUR/sqm/month and 8.20 – 14.50 EUR/sqm/month in B-class office buildings.
- Eastnine purchasing an office building from Vastint was the biggest investment transaction in the market this year. *Z1* acquisition is a strong proof for A-class office resilience through the shifts in demand for an asset class as such.
- Linstow acquired the *Sporta 2 quarter*, which is planned to be developed as a modern and high-quality mixed-use area in Riga, focusing on sustainable office developments.

ECONOMIC OUTLOOK

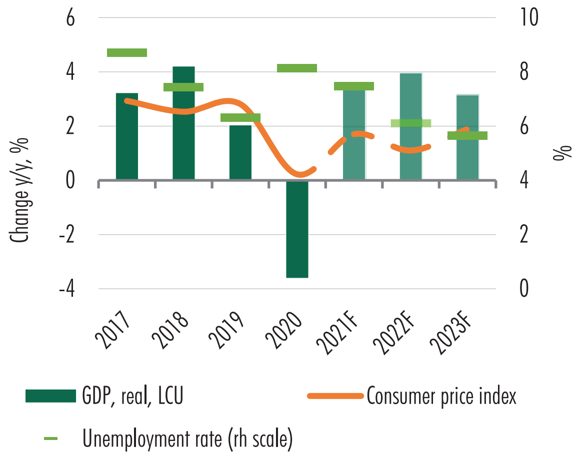
The country's economic development from the beginning of last year has been highly impacted by the ongoing pandemics which resulted in a 3.6% decrease in GDP, a lower inflation rate, and increased unemployment in 2020. In 2020, the real GDP per capita is estimated at EUR 12,130 by Eurostat, reflecting a 3% decline from EUR 12,510 in 2019. GDP in 2020 declined less than expected on account of favourable financial conditions, government support and various economic agents that were able to adapt to the pandemic restrictions; GDP is expected to increase in the coming years on the back of higher external demand as well as the financing under the European economic recovery instrument, which facilitated new investment and exports in 2021.

An estimate released by the Central Statistical Bureau of Latvia shows that in Q1 2021, compared to the same quarter of 2020, GDP decreased by 2.2%. According to provisional estimates, it was affected by a drop of 1.3% in producing sectors and a reduction of 4.0% in services sectors.

A much more significant easing of restrictions will be possible once the level of vaccination coverage reaches a substantial part of population, that is estimated to happen towards autumn. This is likely to provide a strong short-term boost to growth as restricted parts of the economy reopen. GDP growth is expected to rebound in 2021, achieving a 4% increase according to Oxford Economics, with the largest contribution to growth coming from private consumption and exports.

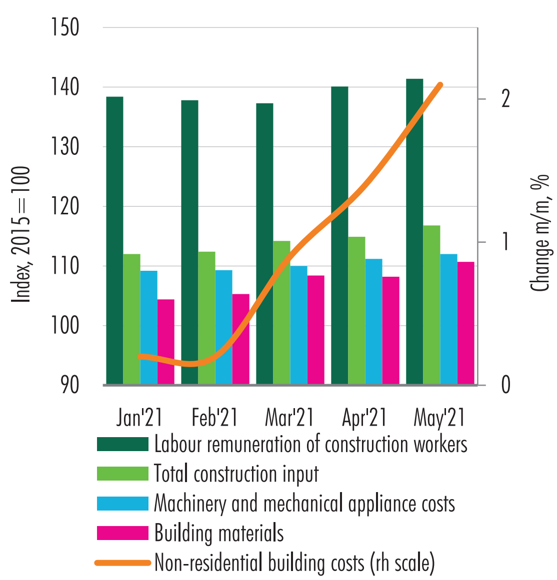
The inflation dynamics is affected by a rise in global demand causing a surge in commodity prices. On account of an increase in global oil and food prices, the inflation forecast by the Bank of Latvia has been revised from 1% in the beginning of the year upwards to 2% in 2021 and from 2.2% to 2.9 % in 2022, with a possibility to increase further. External uncertainty and weakening external demand have been reflected in lower growth rates of exports and imports significantly affecting foreign trade in goods and services in 2020. Export growth by The Bank of Latvia is estimated 5.9% in 2021, with Latvia's trade partners having addressed the crisis with smaller losses than the EU average last year and their economies rebounding from a better start position this year. With the external and particularly the domestic demand improving, imports of goods and services will also see accelerated growth.

Figure 2: GDP growth, inflation and unemployment rate



Source: Oxford Economics, CBRE Baltics, 2021.

Figure 3: Construction cost index change, M-o-M

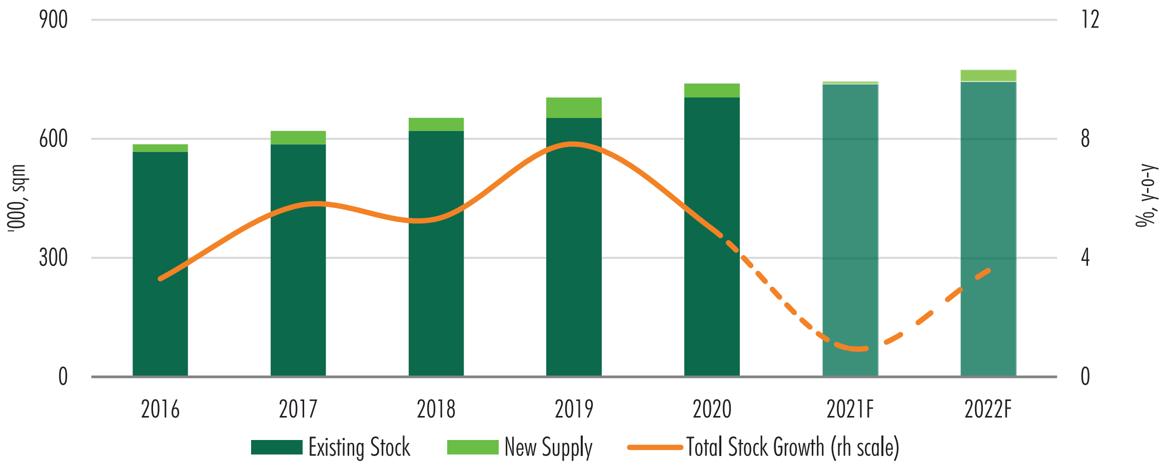


Source: Central Statistics Bureau of Latvia, CBRE Baltics, 2021.

Construction costs are up by 5% compared H1 2020, mainly driven by rising cost of materials - increase in the prices of sand, metal and metal products. Nonetheless metal prices are expected to grow by 30% this year. This impact is not yet showing on rent rates, but it might have an influence on the market in the future.

However, the outlook is heavily dependent on progress in containing the COVID-19 pandemic as well as policy support measures and production decisions in major commodity producers.

Figure 4: 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.

SUPPLY

There were no new deliveries to the Riga modern office stock in H1 2021, with two smaller office projects scheduled to be commissioned by the end of the year – *Barons Kvartals* new construction with 5,000 sqm and The Baltic RE Group renovation project *The Icon* with ca. 3,000 sqm that has been pre-let to Printful - ``the first unicorn from Latvia''.

Although vacancy has increased from the previous period developers have not shown any signs of slowing down with more than 100,000 sqm currently under construction and around 90,000 sqm in the planning stage.

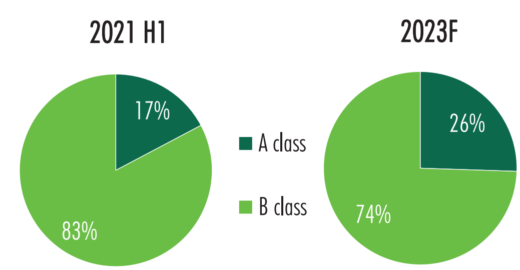
Developers have chosen different areas of the city for their developments – Galio Group is developing *Gustavs* in the VEF area (GLA ca. 12,400 sqm). *Zeiss Offices* by Mukusalas Biznesa Centrs, *Business Garden Riga phase II* by Vastint Latvia, LORDS LB office project *Preses Nama Kvartals* and Urban Inventors development of a multifunctional project will add significant volume - ca. 190,000 sqm of modern office premises to Pardaugava area. The Capitalica office project *Verde* and *Mihaila Tala 1* by Pillar are being constructed, delivering ca. 27,000 sqm of office premises in the Skanste area by the end of next year.

These modern office developments are going to significantly increase the quality of available office stock in Riga. It is predicted that by 2023 A-class buildings will account for more than a quarter of modern office stock in the city.

Architectural competition winners were announced for Eastnine's ambitious development *Kimmel quarter* in the city centre that will offer office premises together with amenities like cafes, restaurants and retail premises. The planned project of ca. 38,000 sqm will consist of reconstructed (ca. 10%) and newly built (GLA ca. 34,000 sqm) volume.

Landlords with vacancies in their buildings will have to compete for potential tenant interest in addition to regular competition with several occupiers that actively are offering to sublease a part of their premises because of adaptation to the new work environment. This is a unique situation for Riga's office market as availability of sublease options in past years has been very low, if any. This will put a short-term pressure on the rent prices as occupiers of sublease premises will be ready to offer more flexible solutions in terms of rent price and incentives in order to reduce their existing monthly payments. We do not expect this trend to continue as the situation should stabilize once employees return to their offices.

Figure 5: Modern Office stock by building class



Source: CBRE Baltics, 2021.

DEMAND & ABSORPTION

As anticipated, occupiers are more cautious when planning their relocation and take extra time before making the final decision. The main uncertainty is regarding required office space as adaptation to new ways of working, where remote and hybrid work environment will play more significant role, will impact future office floor layout and required office space. There is going to be a lot more shared usage of space and necessary space in a hybrid office per person is expected to be higher than previously needed.

On average occupiers are looking for 10 – 20% less space compared to offices before Covid. Many occupiers who were planning an expansion before the Covid-19 pandemic have not postponed their expansion plans but because of the increased share of remote work can implement flexible solutions to accommodate more employees within existing premises.

Q2 compared to Q1 showed a negative absorption as more office premises were vacated than occupied in this period. However, this should not be a continuous trend as occupier activity is expected to increase in the second half of 2021. One of the main preconditions for higher occupier activity will be increased vaccination temps during summer and the increasing pace of workers returning back to offices.

SEB Global Services announced their relocation to the Galio Group office building *Gustavs,* leasing 11,000 sqm. Relocation is planned in H1 2023 when the building construction will be finished.

Several sublease deals were finalized during Q2 signalling occupier interest to relocate to higher quality premises.

During the first half of the 2021, take-up reached a volume of 17,500 sqm or just 2% less than in the same period last year.

VACANCY

Overall modern office vacancy in Riga at the end of Q2 2021 stood at 12.6% which is a slight increase compared to Q1 – 12%. A-class vacancy mainly has increased because of the occupier optimization of existing offices premises and adaptation to increased share of remote work in the companies.

For A-class and qualitative B-class office buildings vacancy will decrease in the foreseeable future as tenants are looking for technically more advanced office premises, better conditions and more flexibility in rental terms. As this new market situation develops, the trend of relocation from B2 to B1 class offices is emerging.

Figure 6: Riga Office Market pipeline

No.	Project	Developer	Year	Status	Class	GLA, sqm
1	Barons Kvartals	Barons Kvartals	2021	U/C	B	4,992
2	The Icon	Baltic RE Group	2021	U/C	B	2,050
3	Verde	Capitalica	2022	U/C	A	15,000
4	Mihaila Tala 1	Pillar	2022	U/C	A	12,000
5	Dzelzavas 45	Arcada	2022	U/C	B	7,000
6	Zeiss Offices	MBC	2022	U/C	A	4,200
7	Preses Nams Kvartals	Lords LB	2023	U/C	A	25,000
8	Novira Plaza	Novira Capital	2023	U/C	A	23,500
9	Gustavs	Galio Group	2023	U/C	B	12,400
Total						**106,142**

Source: CBRE Baltics, 2021.

MARKET RENTS

In A and B1 office buildings rents have remained stable for over a year despite the impact of the pandemic and increasing construction prices. Most pressure is for B2 class office premises that already has been vacant for an extended period and landlords are forced to offer rent reductions. Rental levels in A-class office buildings stand at 14.00 – 17.00 EUR/sqm/month, although Z-Towers are successfully leasing their premises above prime office rent, showing tenant demand for premium buildings. B-class office building rent rates are from 8.20 – 14.50 EUR/sqm/month.

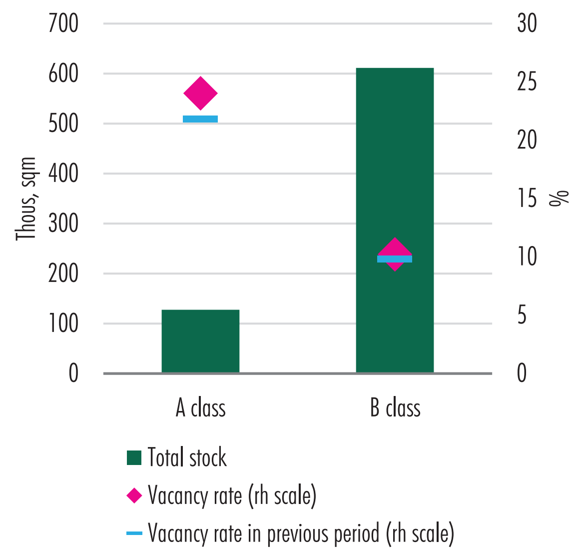
INVESTMENT & TRANSACTIONS

Overall, the capital market in Latvia has been relatively idle comparing to previous times but some sizable transactions are expected in the second half of the year. Prime office yield in Riga stands at around 5.5% showing strong market sentiment decreasing by 50 bp compared to June 2020.

Office investment volumes constituted 12% of transactions in H1 2021, representing only 3% of office investment volumes in H1 2020. The demand for core office properties still exceeding existing supply, thus limiting the number of transactions in the market. However, there are several office transactions ongoing, which could be finalized in Q3 2021. Also, Linstow has acquired the Sporta 2 quarter, which is planned to be developed as a modern and high-quality mixed-use area in Riga, however focusing on sustainable office developments. Currently there are several office development schemes under construction or in the planning phase by Baltic and Nordic developers.

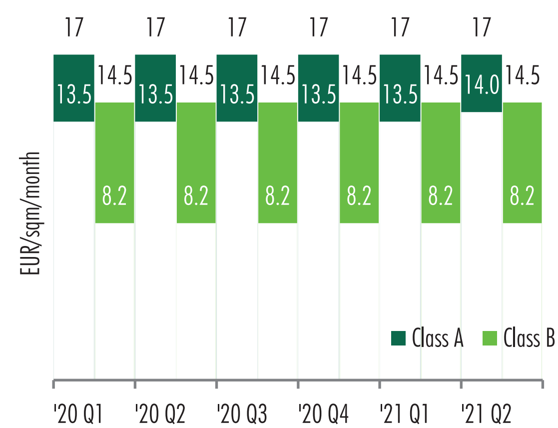
The biggest investment transaction occurred with *Eastnine* purchasing two office buildings in Baltic capitals from the international real estate company *Vastint;* one of the properties located in Riga, *Zala 1* is a LEED-certified building, which consists of over 3,600 sqm of office space. Property is leased in its entirety and among the tenants are *Microsoft* and *CBRE*.

Figure 7: Vacancy rate by office class



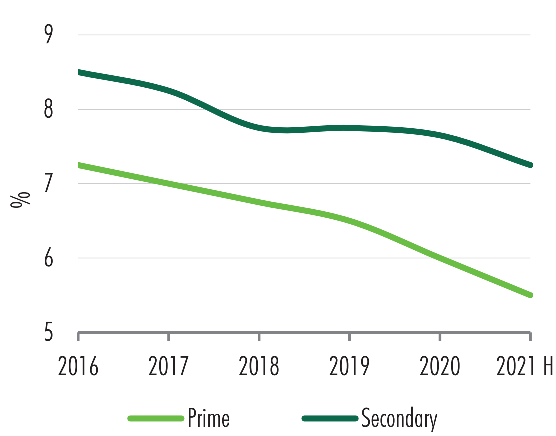
Source: CBRE Baltics, 2021.

Figure 8: Rent ranges by office class



Source: CBRE Baltics, 2021.

Figure 9: Office investment yields



Source: CBRE Baltics, 2021.

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 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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CONTACTS

REINIS LAUSKIS
Senior Consultant| Advisory & Transaction Services
M +371 2832 4165
reinis.lauskis@cbre.lv

ELZA MURASEVA
Junior Valuer| Research & Valuation
M +371 2038 9233
elza.muraseva@cbre.lv

MARTINS GRINBERGS
Senior Analyst | Research & Advisory
M: +371 2617 7874
martins.grinbergs@cbre.lv

CBRE OFFICES

RIGA OFFICE
Z1
Zala Street 1,
Riga, Latvia, LV-1010

TALLINN OFFICE
UMA Maakri
4. korrus, Maakri 19-1,
Tallinn, Estonia, EE-10145

VILNIUS OFFICE
Green Hall 2
Upes Street 23,
Vilnius, Lithuania, LT-08128