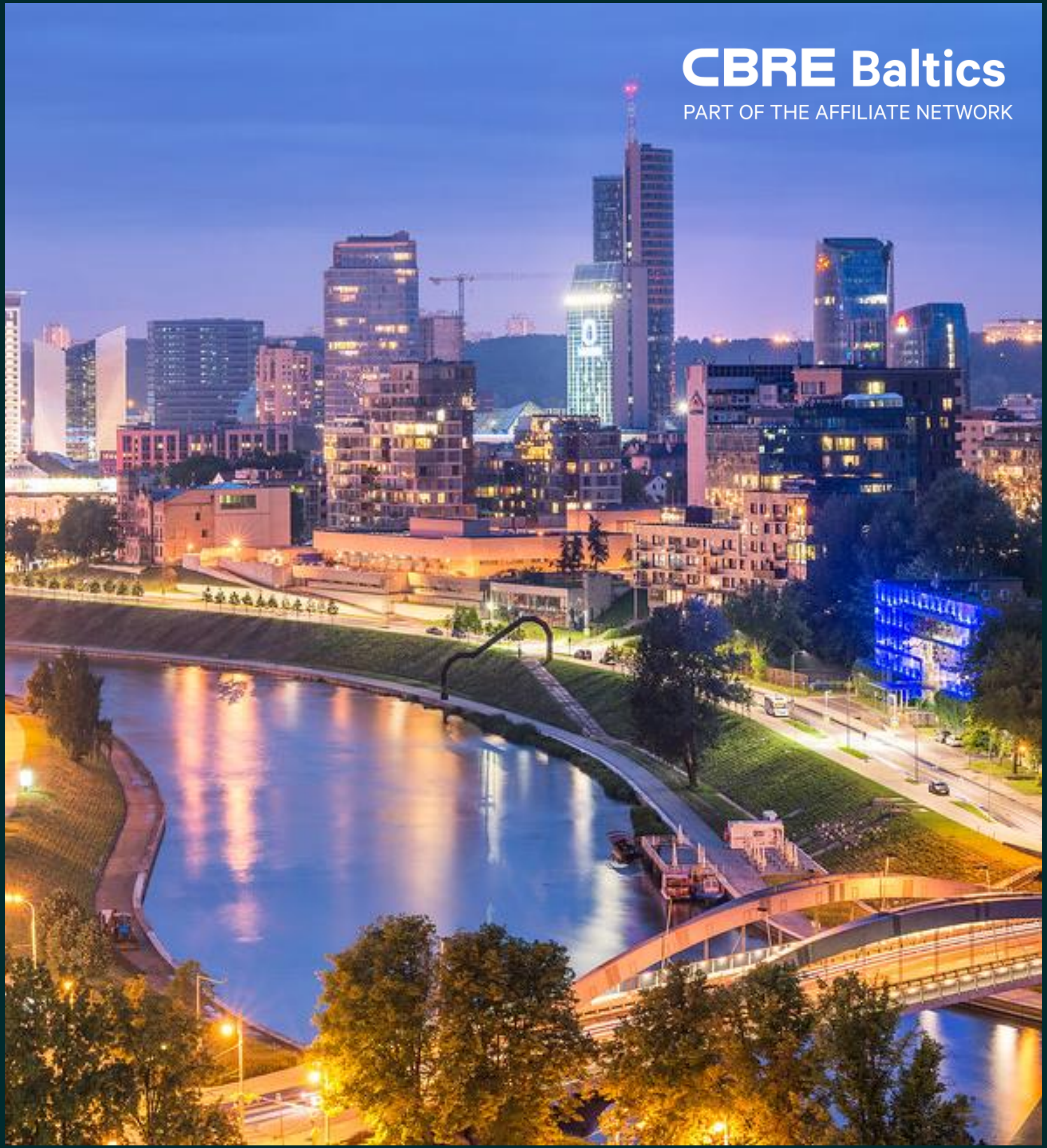
Report | Acceleration

Market Outlook 2022

REPORT

BALTIC
REAL ESTATE

CBRE BALTICS
RESEARCH



Introduction

The small and open economies of the Baltics have faired better through the years of pandemic than European counterparts. The decline of the economies has been rather soft with a certain rebound. As the world economy recovers, so does the export level for Baltic goods and services which reached historic heights at the end of 2021. We expect the tourism and hospitality sectors also to start a gradual recovery in 2022, especially when the Baltic region successfully implements a consistent application of protective measures that will facilitate reconnection with the world more confidently.

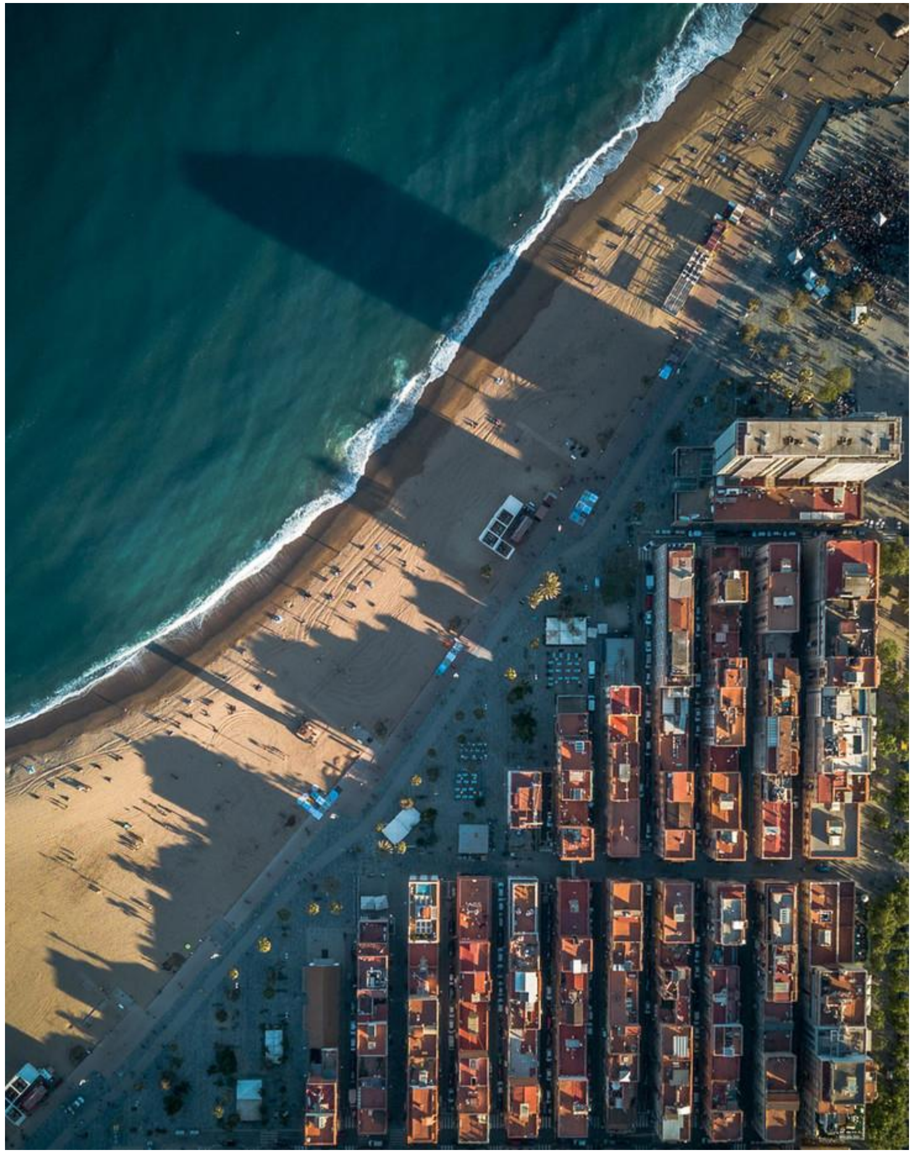
Last year the Baltic markets recorded historically the highest capital investment volume exceeding EUR 1.5 bn. This nominates the Baltics among the few in Europe which exceeded the pre-pandemic investment levels in 2021. We believe that the ever-higher capital investment volume recorded in 2021 across the Baltics is not just a coincidence by leading market players taking advantage of the changing markets to shift the well-established competition.

Office employment will continue to rise, and so will the need for quality offices. New flexible working patterns will be formulated more clearly, which is good news for both the new and refurbished stock. We believe that the rethinking of real estate and health and wellness standards will create the need for reclassifying the A class stock for which the pipeline continues to grow strongly in the capital cities.

Retail will continue surprising consumers by bringing new innovative approaches for using the traditional physical space. Investment in physical space concepts will continue to top the agendas of real estate investors and retailers alike.

As a response to the disrupted supply chain process, global manufacturing and logistic operators will increasingly find the Baltics a well-placed alternative to diversify the risks.

ESG will be top of the agenda for the real estate decisions. Even more, the rising resource cost environment is going to contribute to real estate becoming more energy efficient driven by instant financial goals. Responsible investment principles were discussed but hardly observed during the last fifteen years, and the behaviour has switched now to action.



Contents

01

ESG

Outlook

Sustainability targets have turned from discussions to action in 2021. Increased regulation and shifts in corporate policies are going to drive capital flow and asset selection going forward.

Trends to watch

01 In the context of ESG, real estate sustainability certificates will only increase in growing momentum also across the Baltics in the near future.

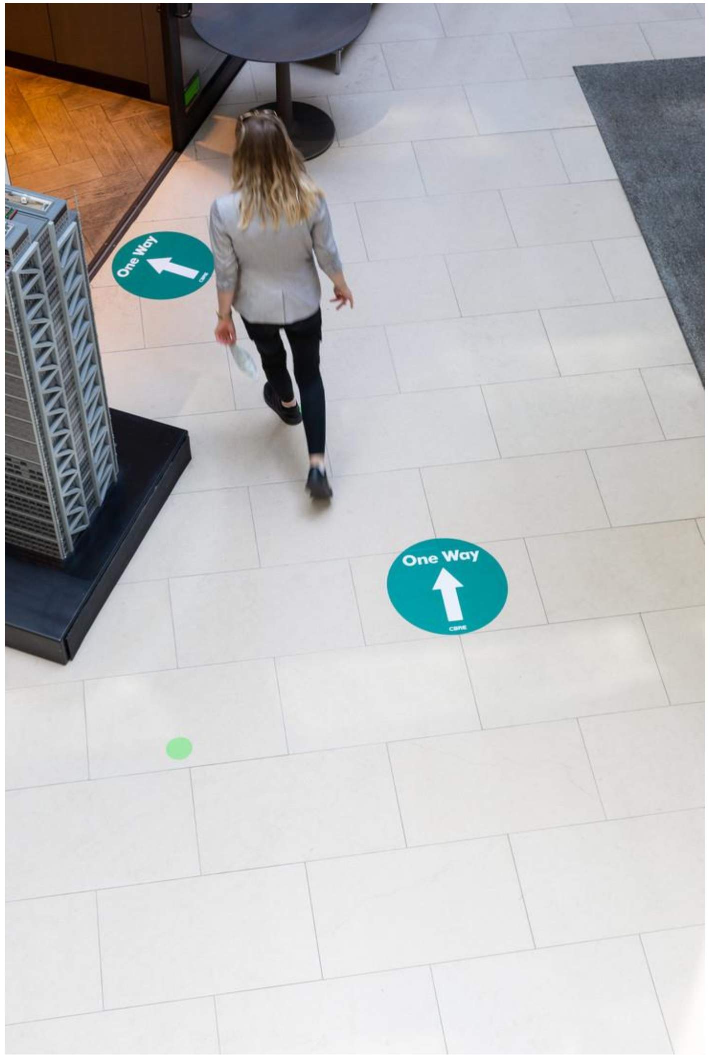
02 An increasing demand is shaping up for advising landlords and investors on how to succeed in reaching the standards that are now followed by international capital as well as corporate occupier commitments

03 As inflationary pressures escalate real estate provides even better alternative investment options because for the first time it is identified that certified buildings generate a premium over the comparable secondary assets

04 EU legislation is becoming more precise in classification of the environmental sustainability for new construction, renovation and the acquisition and ownership of buildings

05 Global Fortune 500 companies committed to achieve climate goals by 2030 or are there already

06 ESG will play an increasingly important role in retaining and attracting talent



> "Real estate strategy should incorporate more than facilities and space - it should incorporate the community."
>
> Rob Lowne
> Senior Director of Real Estate
> Microsoft

Business driven shifts

On a back of lasting severe weather events accross wider geographies, the COVID-19 pandemic and labour shortages, businesses need to revive in different ways. Increased awareness of social responsibility, transparent operations and environmental matters have triggered a regulatory framework enforcement as a consequence. Europe is in the driver's seat trying to guide capital towards sustainable assets. European sustainable mutual funding was greatly supported by the Sustainable Finance Disclosure Regulation (SFDR) in 2021. SFDR will be supplemented by Regulatory Technical Standards (RTS) scheduled for implementation in the beginning of 2023.

At all governmental levels the Baltics have committed to climate neutrality in the next few decades. This will create not only the cross-border capital to implement strict ESG agenda in the next decade, but also force any professional real estate investor to follow the principles rigorously. The set commitments are to enhance a data quality-driven analysis that paves the course from strategy to motion.

Under an EU non-financial reporting directive (NFRD) starting June 2021 in Estonia and January 2022 in Lithuania for industrial and other companies that have to publish non-financial information there is a mandatory requirement to report on how and to what extent their economic activities are related towards environmentally sustainable action.

We see 2022 as a year with more and more data coming to help implement intelligent ESG strategies for a better asset performance.

Sustainable construction

Whether a tenant fit-out, retrofit or built-to- suit construction, any of these activities now require the addition of sustainability.

Among others Skanste City office hub in Riga, announced that it was following green energy targets by installing more than 2800 sqm of roof top solar panels reducing carbon emissions by 400 tones annually.

Energy efficiency is the base component on a path to net-zero, minimized business interceptions and operation costs.

Taking into the account increasing resource costs labour shortages and environmental considerations all of the CRE capital investment orientated development pipeline is going to need a recognized energy certificate.

Nonetheless, the future of the workplace suggests we go even beyond energy efficiency. In a labour shortage environment, to retain the talent back into the office, occupiers will also need indoor sustainability – air, water, nourishment, light, movement, thermal comfort, sound, mind, community. The International WELL Building Institute supports certification for all of the amenities mentioned above by a performance-based WELL certificate.

33%

of the Baltics competative office stock is environmentaly certified buildings which is c.a. 10% above EU average

70%

of investors accross the Europe have adopted their ESG criteria

21%

office rent premium is paid on average in certified buildings across Europe

Future take-up

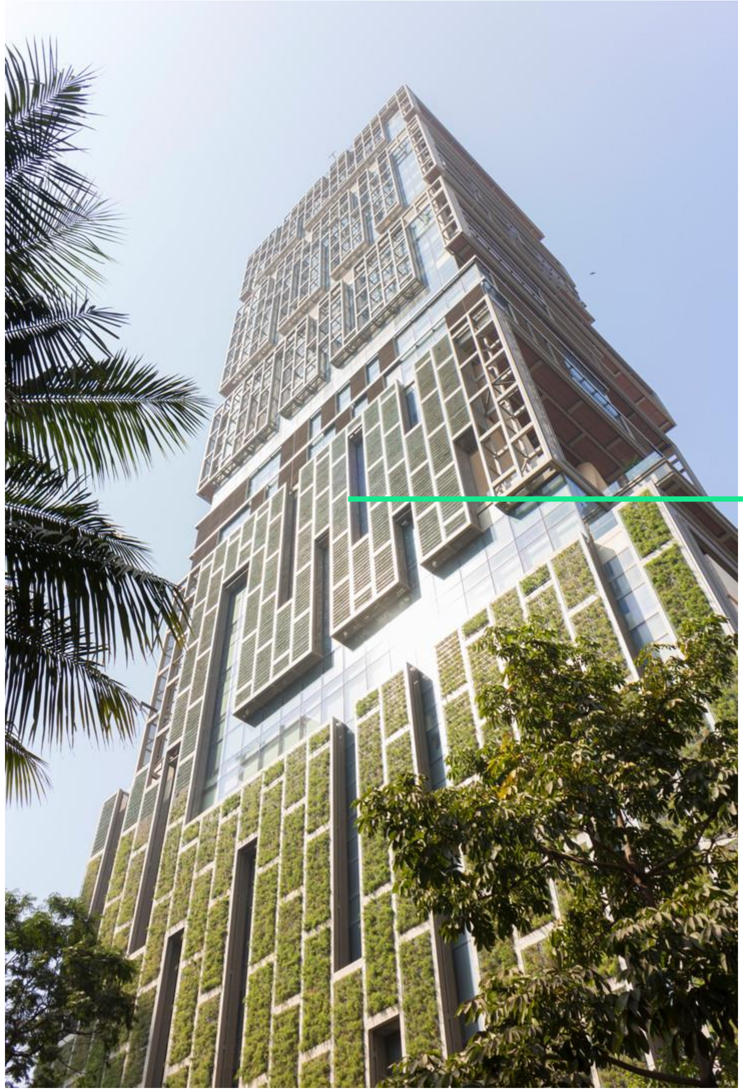
From portfolio optimization measures and green leases to building selection based on energy requirements, occupiers are taking a more proactive stance early in the process to ensure they can meet long-range sustainability goals.

Eastnine, one of the leading Pan Baltic investors, declared the energy certification of all of their assets within the six months after acquisition if no major refurbishment is taking place instead.

KPMG stated in 2021 that 83% of investors surveyed expect growing demand for sustainable buildings from tenants; 54% have already decided to take necessary measures in meeting ESG requirements in their portfolios. Landlord and tenant partnerships in a shared ESG vision is a key element to ensure that tenants can succeed in this space.

Sustainable building operations can be greatly promoted by «green leases» by realigning energy cost structures. Both the landlord and the tenant will benefit by conserving resources and ensuring the efficient operation of a building.

Even though the building certification is a point-in-time time metric, it can be successfully used as a first element in the search for a landlord to partner with the occupier in achieving the tenant’s ESG targets.



A «green lease» address with various, energy - aligned matters creates a win-win for both the landlord and tenant to invest in sustainability

02

Economy

Outlook

To mitigate the highest inflation rates in the Baltics since joining the euro, long-term interest rates must be increased. Global energy costs and tensions in supply chain will slow down the economic recovery pace in 2022. Outlook remains positive for prime real estate sectors.

Trends to watch

01

Manufacturing activity and exports, consumer spending and policy management to remain the main factors affecting the economic recovery pace.

02

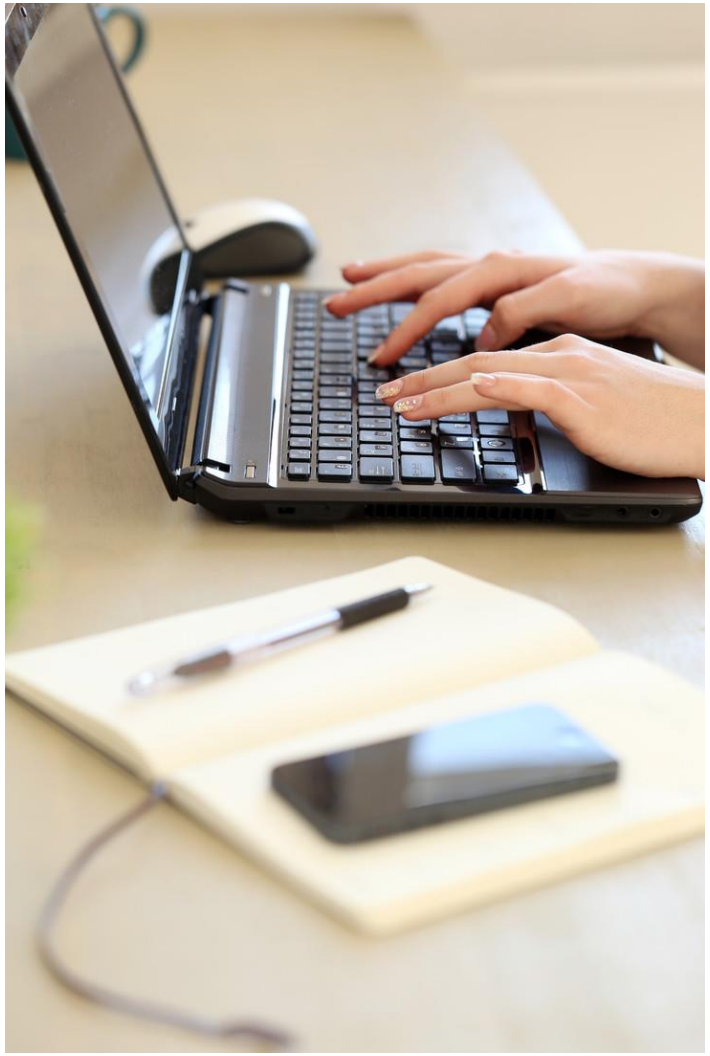
Supply chain disruptions, rapidly growing energy prices, and higher than ever product and labour shortages will moderate the economic growth rate in 2022.

03

With consumers accumulating a substantial portion of savings during the pandemic and with the easing covid situation, we anticipate a significant switch of demand from durable goods into reopened services already in the second half of 2022.

04

Long-term interest rates should increase to mitigate the highest inflation rate since joining the euro in the Baltics. However, even with increased long-term interest rates and higher cost of capital, the outlook remains favorable for prime real estate properties.



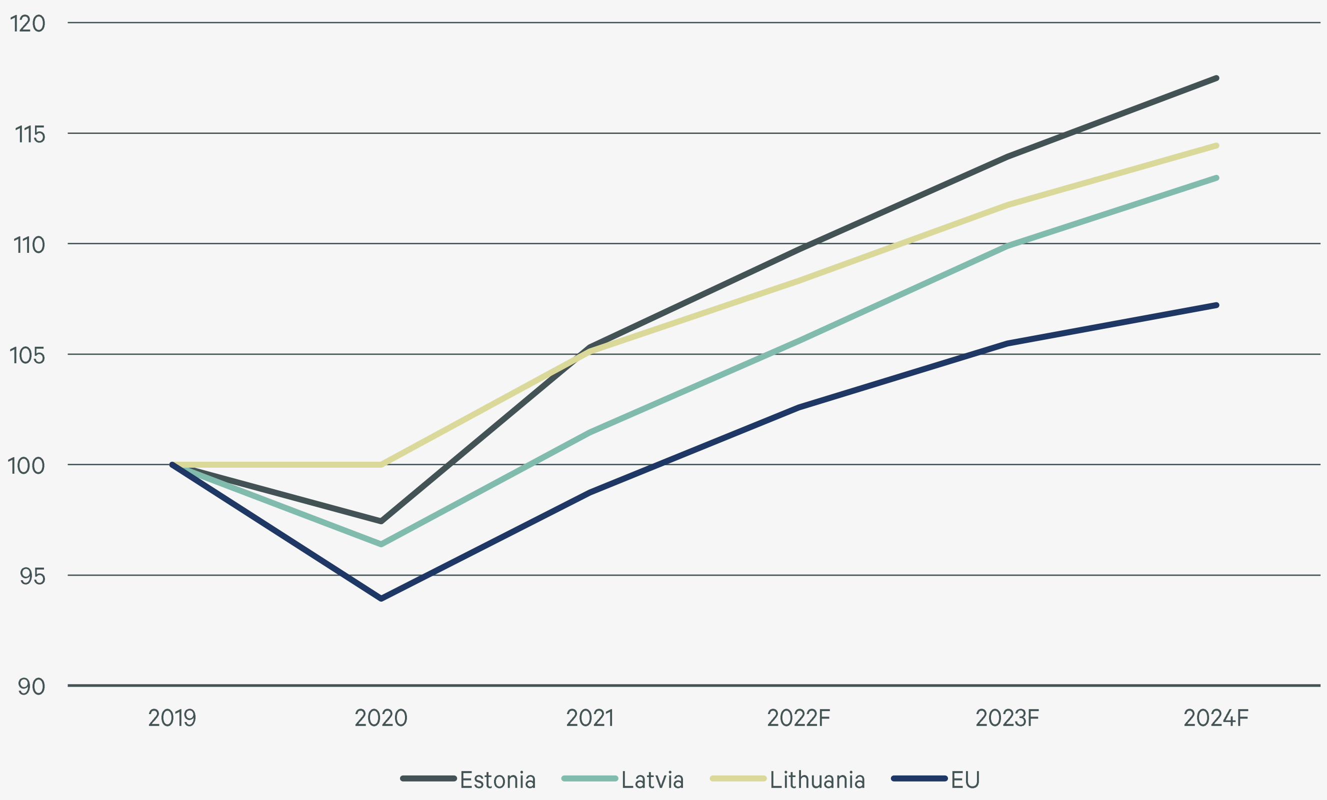
Growth to pick up pace later in 2022

Baltic economies have recovered from the pandemic-induced recession already in 2021, with Lithuania even avoiding the negative GDP zone. The growth has continued at the end of 2021 however the pace has slowed down in the Baltics. Strong manufacturing activity, governmental support, and exports have been fueling the economy during the pandemic. However, with accelerating COVID-19 cases, supply chain disruptions, rapidly growing energy costs, and higher than ever product and labour shortages, the economic growth rate has moderated.

With one of the highest inflation rates in the European Union, the risk of inflation being not temporary would be a heavy burden in the Baltics. However only a third of Baltic inflation is due to domestic factors, namely increased cost of services. Although the European Central Bank is not expected to raise interest rates until 2023, the inflationary pressures should already be reduced by the decline in the prices of energy resources, which is anticipated after the winter heating season globally. However, the tensions in the supply chain are expected to remain and normalize only in 2023.

Although purchasing power has already decreased, we anticipate a significant switch of demand from durable goods into reopened services already in 2022, with consumers accumulating a substantial portion of savings. With an easing covid situation and fiscal policy management, we remain positive that household consumption will further stimulate the economy. However, the potential danger of an overheating economy due to a wage-price spiral and tightening labour market will be present in the Baltics in 2022 and beyond.

Figure 1: Real GDP, 2019 = 100



Source: Oxford Economics, CBRE Baltics Research

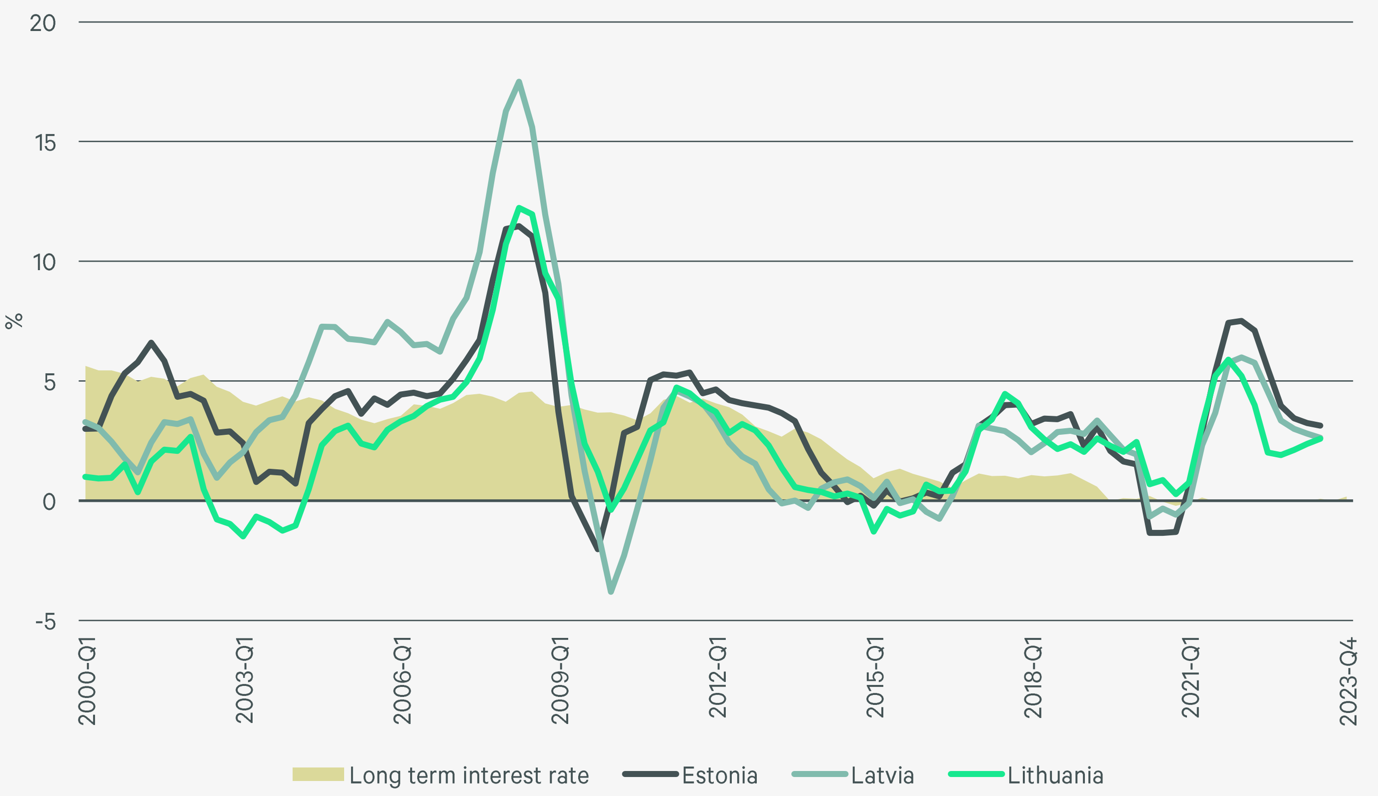
Inflation and interest rates

A low interest rate environment during the pandemic has supported commercial real estate pace in the Baltics, as well as improved affordability in the housing sector. However, long-term interest rates are expected to rise from the low levels experienced during the peak of the pandemic.

The hikes in long-term interest rates are to be driven by accelerating economic recovery, as well as the European Central Bank reducing the pandemic-related quantitative easing programs already in the beginning of 2022. We do not however anticipate a rapid jump in interest rates to disrupt the property markets. As a result, with rising real interest rates and reduced asset purchases from the Central Bank, the outlook remains highly favourable for prime real estate assets.

Even with increased long-term interest rates and higher cost of capital, we expect further yield compression for prime real estate assets, which is driven by increasing economic growth and strong real estate fundamentals in the region.

Figure 2: Inflation and interest rates



Source: OECD, CBRE Baltics Research

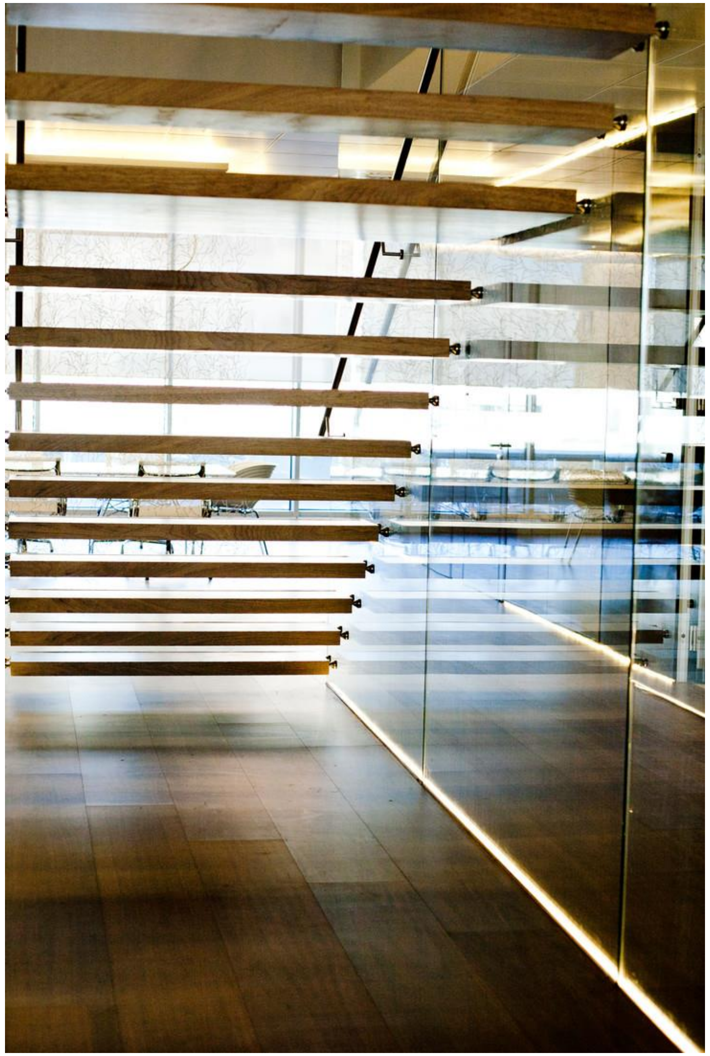
03

Investment

Outlook

Positive investor demand in the region will increase the competition for core real estate assets. Multi-family rental sector is expected to emerge in the region. Secondary locations and alternative sector will gain momentum.

Trends to watch



01

After a record year of investment volume Globally beating the level of 2019 by 21%, also the Baltics investment market shows positive sentiment. Investors will continue hedging against inflation across all property types.

02

With strong occupational demand for office space and limited stock available for industrial and logistics in particular, rental growth and further yield compression is anticipated in 2022. Growing consumer consumption and long lease covenants to elevate the investor interest in the retail sector.

03

New institutional investors should emerge in the multi-family rental segment through forward agreement deals with developers. Multi-family rental is expected to set its yields and will compete with prime office pricings.

04

Core and core plus strategies remain popular among investors. However, interest in value-add, secondary locations and alternative sectors are expected to gain momentum in the post-pandemic environment.

05

We anticipate new investors (and operators) from the Baltic sea region to enter the Baltic market to compete for the yield premiums.

06

Pricing for all asset classes is expected to strengthen. Upward pressure may intensify for logistics and prime offices, while expected discounts in retail, hotel and value-add office assets should narrow.

Investors to continue absorbing yield premiums in the Baltics

Given that investments have almost doubled year-on-year and grown by 30% compared to 2019, which was a record year for capital markets before the pandemic, the Baltics investment market shows positive sentiment in the region.

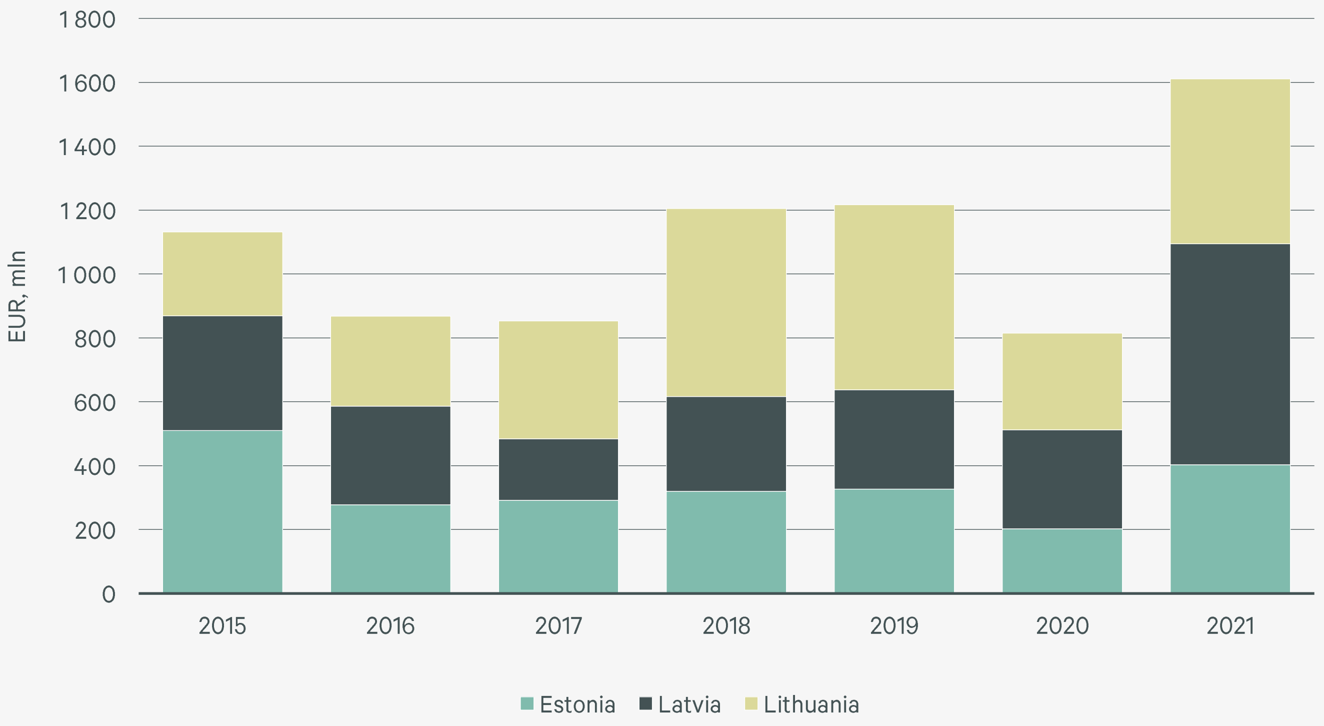
Increasing inflation drives capital even more to continue seeking for real estate assets in particular; hence, investors continue searching for premium yields in the Baltic region. With a strong occupational demand for office space and limited availability in the industrial sector, we expect a further yield compression for prime assets which will likely result in rents going up after all. Nevertheless, the yields and premiums are still higher if compared to other European countries.

Although the retail sector was affected rather severely by the pandemic, investment volumes in retail led the market in 2021. Since the largest shopping centre acquisitions were made either by leading retail developers or financing companies and non-typical retail investors, the demand for long lease covenant assets remains strong and growing consumption suggests that investment into the sector will steadily continue.

With a strong occupational demand and decreasing vacancies in office and industrial sectors, both markets are expected to remain strong in 2022. As occupiers are willing to retain an office space and many have already decided on a hybrid work model, a strong competition for A class space is going to secure further investment volumes. While increasing rents and limited stock for industrial and logistics shall further compress the yields.

Although only a few deals accounting for about 7% of Baltic total investment volumes have been closed in the multi-family rental sector in 2021, following a global trend and a limited product availability across the Baltics, we anticipate that institutional investors will increase investments through forward agreements with developers, as witnessed from the first acquisitions in the segment last year. Multi-family rental will compete with prime office pricing.

Figure 3: Investment volumes, Baltics



Source: CBRE Baltics Research

Alternative sector will gain momentum

Stakes are getting higher, but will there be a break?

According to the European Investor Intentions Survey, the office sector is (again) the most preferred property type for European investors in 2022. It was mainly driven by improving expectations for a return to the office and strong real estate fundamentals.

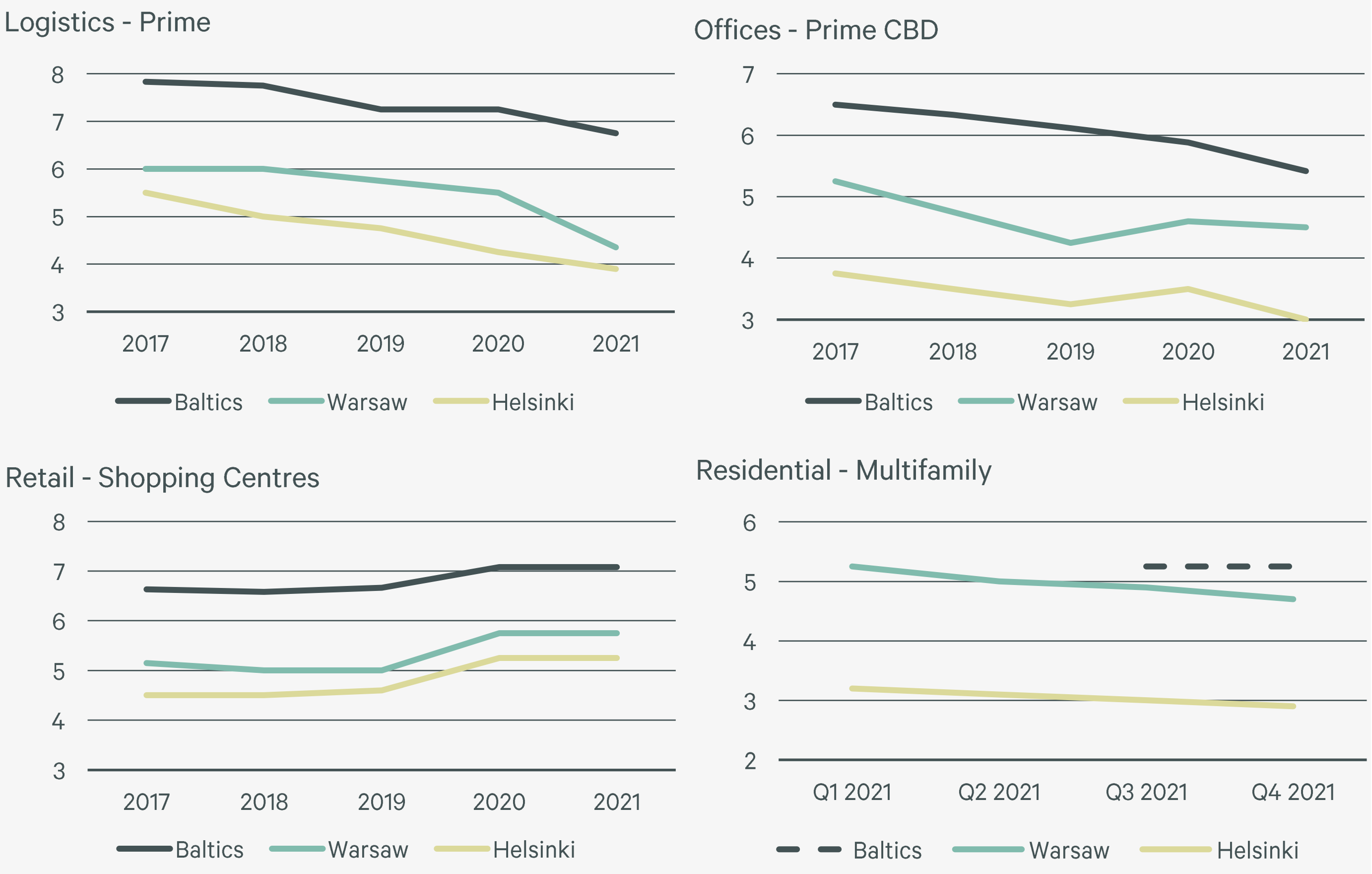
A tremendous capital availability has pushed the prime asset prices sky-high across Europe's core markets. Consequently, institutional investors in searching for higher returns started to consider value-add assets in secondary locations and alternative sectors. We expect a similar tendency in the Baltics as well.

During the COVID-19 pandemic, there has been a pricing mismatch between the sellers and purchasers, as distressed sales have been negligible. The same was evident also in the Baltics. Therefore, we do not expect sales of major hotels until the operation metrics improve, which mainly depends on easing restrictions and travelling getting back to normal. However, it is a favourable timing for new operators to enter the market, and we expect new brand names this year.

With strong occupational demand for the alternative housing sector, we believe that more conversions into co-living or micro-living schemes will appear in 2022. The drivers for that are a lack of professional management in private apartment rental services and high capital values in the residential sectors.

In 2022, competition for prime assets is expected to strengthen. As a result, upward pressure on yields may intensify for logistics and prime offices, while expected discounts in retail, hotel and value-add office assets should continue to narrow. In addition, more investors might appear in the market whose core business activities are not related to real estate to hedge against inflation risks.

Figure 4: Core market yields comparison, selected regions



Source: CBRE Baltics Research

04

Offices

Outlook

Amidst labour shortages, increasing inflation and the highest ever construction cost environment we expect a prime rent moderate increase. New working patterns are still being established which will result in general demand for quality and flexibility in space.

Trends to watch

01

Hybrid work model has become a new normal - COVID crisis was just a catalyst for the transformation to happen now. Changes in the workplace will no longer cause as much concern in 2022 as in the beginning of the pandemic

02

Flexible offices are in high demand and this trend is projected to carry on due to the increasing hybrid work model.

03

Increasing construction costs, combined with strong tenant demand for A class offices and limited supply of such premises in the market will put upward pressure on rental prices during 2022.

04

With sustainability being essential to tenants, developers of the new buildings will become more interested in carrying out building environmental certification and using it as an additional advantage over competitors, highlighting the benefits of the project both for the environment and to the occupiers.

05

Although the projected pipeline for 2022 is one of the biggest in recent years, it is expected to have no significant impact on the current vacancy in the Baltics.

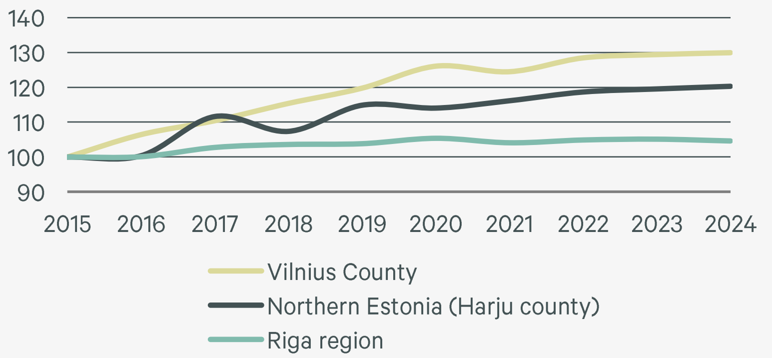
Vacancy

During the pandemic turbulence, only a few projects were delayed, but none were cancelled. New developments are being constructed despite the issues raised by the pandemic and with the positive "return to office" sentiment and increasing demand for office space from the occupiers. Hence, office construction should be resilient to any forecasted market fluctuations in all three Baltic countries. More than 260,000 square meters of office space will be commissioned in the Baltics in 2022. Given that ca 48% of the new stock has already been pre-leased, it shouldn't significantly affect the current vacancy rate in the Baltics. Vilnius and Tallinn office markets will be the main drivers for new office building deliveries in 2022. Riga will account for only ca. 10% of new developments in Baltic states. It is expected that vacancies will see a downward trend for Riga's office market in 2022 as a result of only ca. 26,000 sqm expected to be delivered.

Rents: upwards pressure for A-class rents

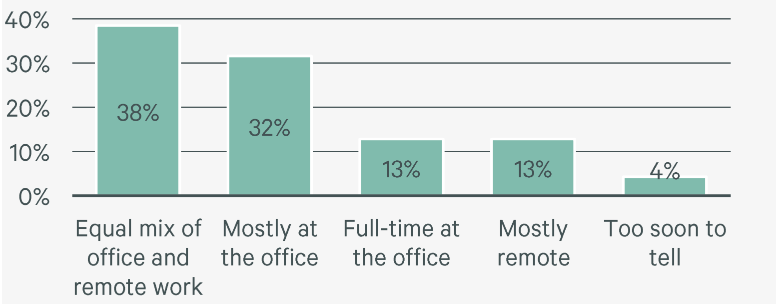
Since the beginning of 2019, office rents have fluctuated a bit in the Baltics. With the segment witnessing a panic in the initial year of the pandemic, the market has gone through a reset and returned back to the pre-covid levels within 12 months. The growing construction costs, combined with strong tenant demand for A-class offices and limited supply of such premises in the market, will put upward pressure on rents for 2022.

Figure 5: Office-based employment, 2015 = 100



Source: Oxford Economics, CBRE Baltics Research

Figure 6: Future workplace policy intentions



Source: CBRE Baltics Research

However, we do not expect substantial changes in rents in B class offices across the Baltics. The reasons for the stability in B class offices rents are the relatively high vacancy rate, increasing competition from new A-class office buildings and limited demand from tenants.

Sustainability

Many developers don't have a clear vision of the future of the workplace, but despite the rising construction costs, the demand for new office space is growing. Currently, 33% of the office buildings in the Baltics are certified: 19% BREEAM and 14% LEED. While it wasn't a problem for the developers in the past, more recently, investors and occupiers are looking increasingly towards more sustainable buildings, while developers keep high on the agenda the certifications of their new constructions. Landlords of older office buildings are also trying to keep up with demand, and those buildings will also start to receive certificates as well.

2022 will see a more significant divergence in performance and pricing between prime and secondary office buildings. Occupiers and investors will increasingly look towards new and more sustainable buildings. Buildings that demonstrate the highest sustainability standards will ultimately have the best possible outlook for the future, while others will start struggling.

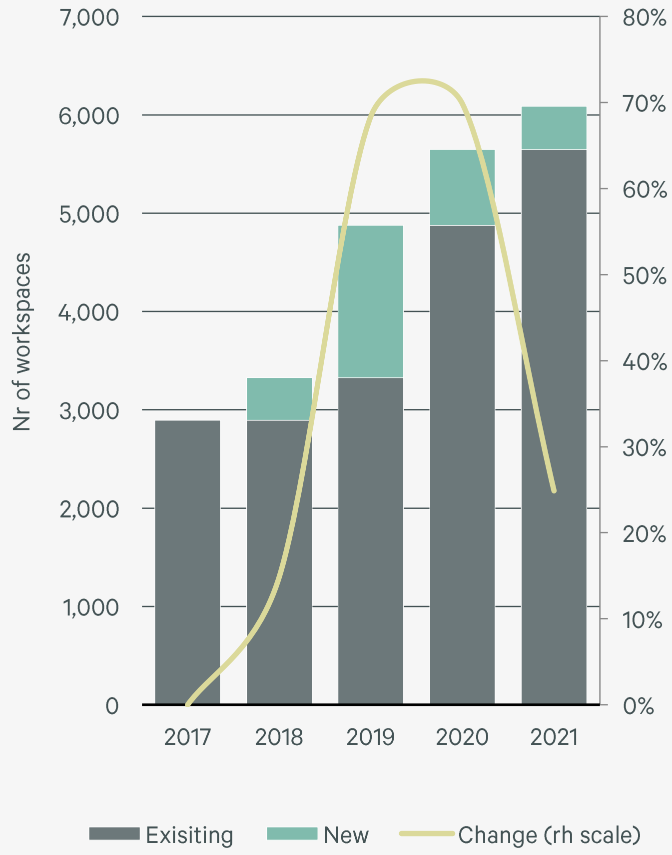
Covid 19 only accelerated the inevitable

The hybrid work model has become a new standard - the COVID crisis was just a catalyst for the transformation to happen now. Changes in the workplace will no longer cause as much concern in 2022 as at the beginning of the pandemic.

However, next year should be considered a turning point to redefine these new requirements across all Baltic countries, as most tenants have already adopted the most favourable working model affecting final real estate occupancy and new requirements. For most, it includes reducing or not increasing the occupied office space while increasing headcount. According to the CBRE Baltics Occupier survey, 52% of the occupiers plan to have no change in their office space, while 52% plan to increase their headcount. However, we have seen some smaller occupiers permanently switching to a working-from-home model and seeking for premature termination of their lease agreements.

The CBRE Baltics Occupier Survey results revealed that 83% of occupiers in all three countries have already implemented a hybrid work model at some capacity. It is likely that in 2022 we will have a clearer picture of the actual proportion of employees returning to physical offices with pre-covid life rhythm restoring

Figure 7: Co-working space growth



Source: CBRE Baltics Research

Flexible office space will become even more demanded

Co-working and serviced office concepts are in high demand, and this trend is projected to carry on due to the increasing hybrid work model. It's mostly due to some factors such as:

- Many tenants have not decided on their long-term covid related real estate strategy;
- Many tenants can't expand due to a lack of available options on the market, which offer decent flexibility and growth potential;
- There is strong interest from international occupiers who require a high recruitment pace and fast expansion, and this segment is the only one to offer that.

There is no doubt, during the initial months of pandemic, this concept was the first to take the 'hit' due to the nature of month-to-month agreements and most of the occupiers terminated their leases immediately. However, flexible offices have their benefits, as their shorter leases will reflect the changing market conditions and can adjust to rent swings the quickest. Therefore, not only can it bounce back from downturns way quicker but also take advantage of rental growth faster than long leases.

05

Logistics

Outlook

Built to suit developments were driving the industrial market so far. We could see this trend beginning to change. The concept of logistics is reshaping however by stock office developments gaining a momentum.

Trends to watch

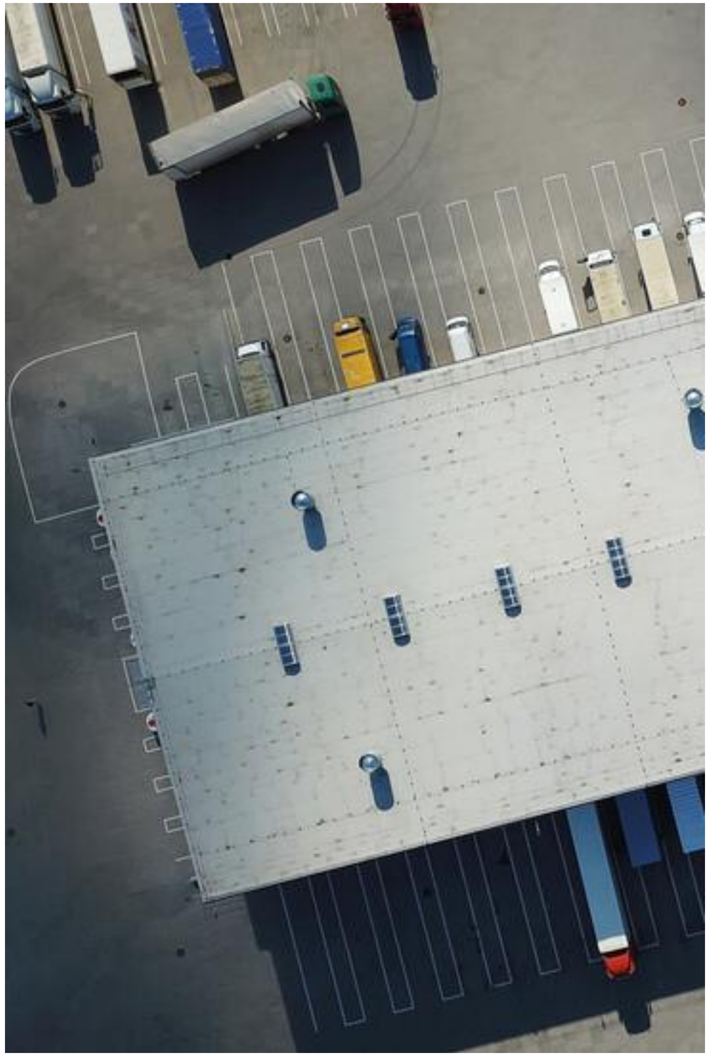
01 Prime rents in Baltic industrial and logistics assets have remained stable over 2021 and it is expected that this trend will continue in 2022

02 While e-commerce is currently making record sales, it is expected that the demand for new warehouse projects will grow.

03 The reported vacancy rate for the industrial and logistics segment in the Baltics is around 3%, and with the growing demand, it is expected that this figure will reduce further.

04 With strong occupational demand and decreasing vacancies in the industrial and logistics sector, the investment interest for the segment was high in 2021 and it is expected that this trend will continue into 2022.

05 Across the Baltics there are many older buildings, and with the utility costs hiking, occupiers of those buildings are considering other, more efficient solutions.



Existing factors are changing the overall picture of the sector

Rents: past and future look similar

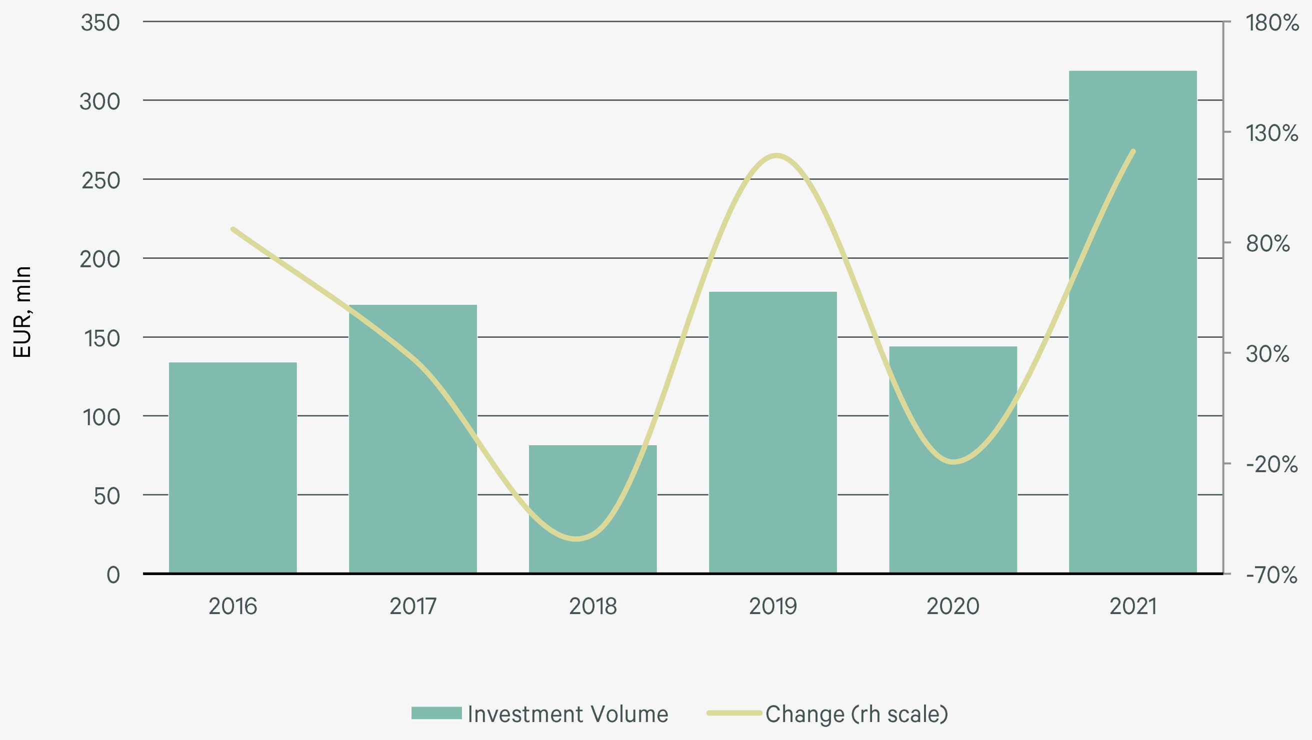
While the YoY prime rental growth across Europe grew by 4.1%, the average rents in Baltic industrial projects have remained stable over 2021, and this trend is likely to continue in 2022. In the future, the growth of rental prices for new tenants may be stimulated by the growing demand for such schemes, rising construction prices and the introduction of new taxes (case of Lithuania). Hence, new developments will become more expensive, and the rents are expected to increase slightly.

E-commerce is raising the demand

During the pandemic period, most e-commerce businesses in the Baltics carried out development investments that, if not in the current situation, would only be carried out in the future. During the pandemic's peak, most businesses in the Baltics improved their sales revenue. With E-commerce making record sales, we will probably see more warehouse projects being developed for the sector in the next 36 months.

We believe the number of speculative warehouses should increase to meet the current demand in the Baltic States. The time spent for an occupier to get a new built-to-suit warehouse ready takes up to 18-24 months, which is too long for many tenants. However, the bank financing which crucial to majority of the local developers, may keep the developmen pace steady.

Figure 8: Investment in Industrial & Logistics 2016-2021



Source: CBRE Baltics Research

As the supply is on the lower side across The Baltics, we expect developers to keep the focus more on new developments instead of refurbishing the outdated stock.

Decreasing vacancies

The reported vacancy level in the Baltics is around 3%, and with the growing demand, we expect that number to lower even more. Many smaller occupiers turn to stock-office solutions with larger warehouses in high demand by the leading distributors. We have already seen this trend in Estonia for the past five years. The small business units (SBUs) have worked for both tenants, who can combine their showroom with their warehouses and the developers, seeing very low vacancy and higher rent options. This trend is supported by roughly half of the Baltic industrial pipeline consisting of stock office developments.

With e-commerce influencing the market, we expect smaller tenants to look even more towards SBUs, while more prominent players occupy bigger warehouses.

Development is slow compared to the rest of CEE region

Historically we have seen that most of the logistics and industrial pipeline consists of built to suit developments, with speculative projects being rather rare.

With e-commerce growing, many developers will show more interest in speculative warehouses. However, it is expected that for the next year or two the main focus will stay on the built-to-suit developments.

Across Europe, industrial development was very intense over the past decade; therefore, the majority of investors tend to refurbish the existing stock for green certification

As the supply is on the lower side across the Baltics, we expect developers to keep the focus more on sustainability for new developments. According to the Investor Intentions Survey 2022 by CBRE, at least 50% of the field believe that the demand for prime industrial will lead to c.a. 10% increase in prime logistics capital values across Europe.

2022 is looking promising

Supported by healthy occupier demand, the prospects for the year ahead look promising. As is the case in the rest of Europe, the logistics sector will remain one of the most preferred choices for investors in 2022. The competition to secure land and the best projects will intensify. The interest for prime industrial and logistics assets will continue to increase, and this is expected to lead to further yield compression over the next 12 months.

4.1%

year-on-year prime I&L rental growth in Europe

€318 M

Total I&L investment volume in the Baltics, a 121% year-on-year increase

06

Retail

Outlook

Pandemic related restrictions applied for retail and leisure space are expected to continue easing in 2022. New ambitious developments will continue in all three Baltic states characterized by multi-use approach.

Trends to watch

01

Varying severity periodically punctuated restrictions across the Baltics are easing and a common understanding is developing to maintain a consistent safe shopping and leisure approach in the region.

02

Growing consumer incomes and increasing competition from different channels will continue driving retailers to improve the consumer experience and bring more innovations

03

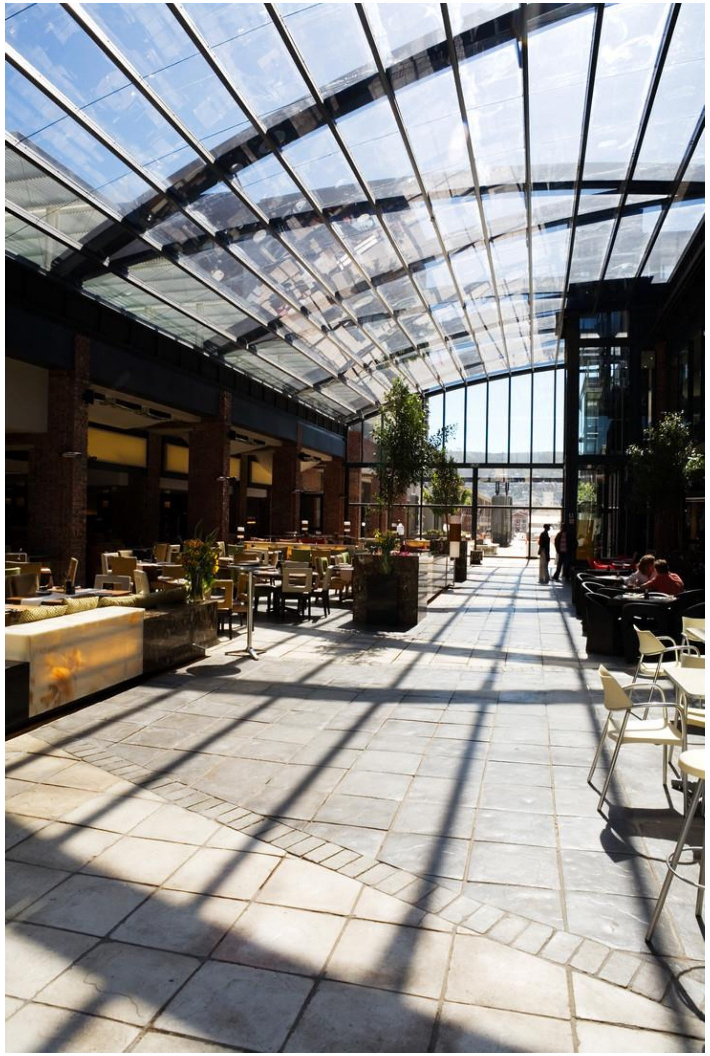
Functional shopping formats to cater for the essential needs of the surrounding community, especially grocery-anchored, will continue increasing its attractiveness for tenants, developers and investors alike.

04

A new range of investors will pay greater attention to retail sector opportunities as the pandemic restrictions continue being lifted, international travel recovers, and growth prospects become more clear.

05

ESG of the retail industry will move more into the spotlight requiring greater accountability and transparency of the supply chains.



Outlook on rents and developments

Headline rents for the sectors most strongly affected by the pandemic will continue softening until full stabilization and a longer-term certainty restored. A greater share of turnovers in the lease structures, larger retailer investments, and landlord contributions to upgrade store formats will also affect net rents in the short term, especially in the new lease and renewal situation.

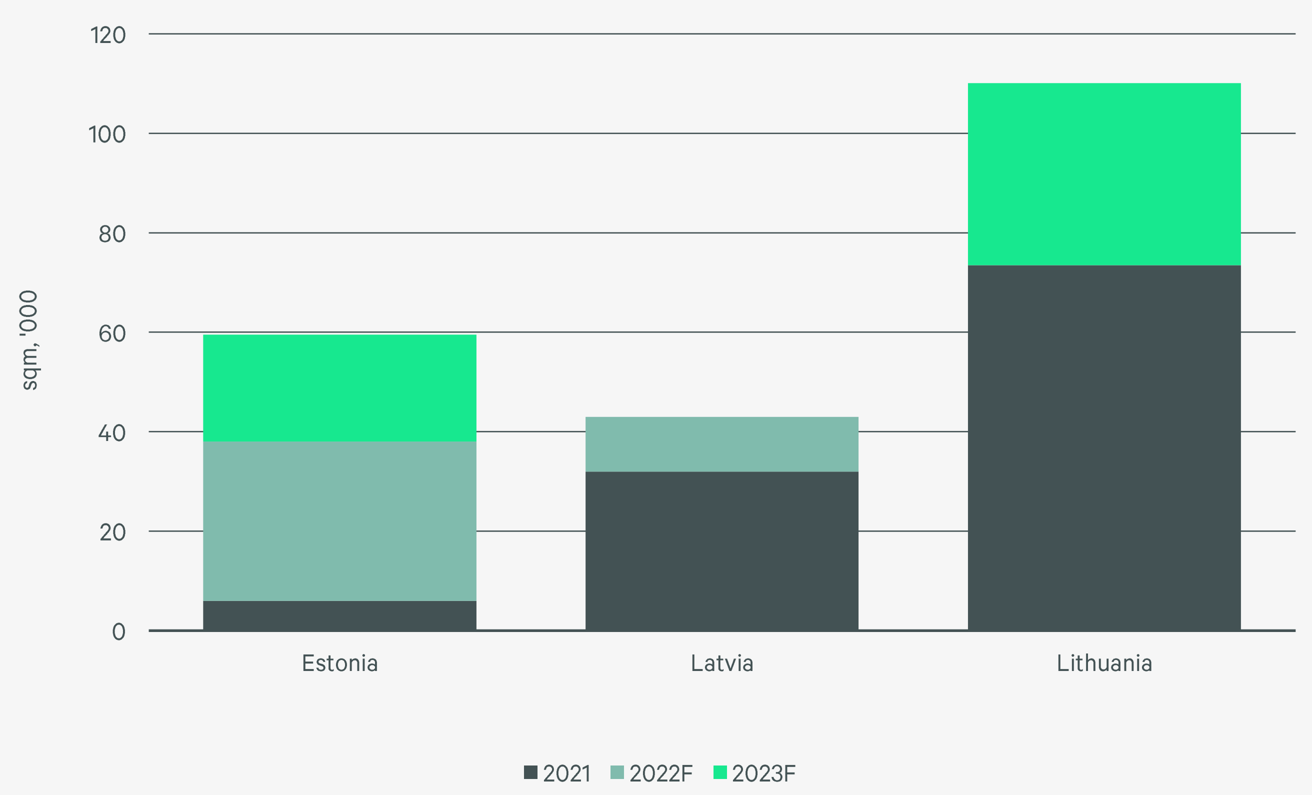
Food retail and community centres, including small retail parks in the cities and regions, are expected to remain the most demanded format by tenants, developers, and investors alike. Slight rental growth and further yield compression are expected in specific locations as there is still room for further expansion.

In the traditional shopping centre sector landlords will continue expanding the multifunctional offering blending a greater variety of everyday services on the one part, and more versatile food & beverage and leisure on the other part. This will continue raising uncertainty for rents and values in the short term.

Despite inflation and rising utilities and construction costs, we expect new ambitious developments in the largest urban areas of the region to continue to be characterized by a multi-use approach where retail is partnered with residential, hospitality, and other sector developments. The strongest pipeline of new retail sqm in the next few years is expected in Vilnius which lagged behind its Baltic neighbours in the previous years.

The remarkably high share of retail investment in 2021 has demonstrated the sellers' and buyers' increased ability in the second year of the pandemic to estimate market growth prospects and required future investments. This will continue attracting a new range of investors in 2022 who will pay greater attention to the retail sector opportunities as the pandemic restrictions continue being lifted.

Figure 9: New deliveries of modern SC stock



Source: CBRE Baltics Research

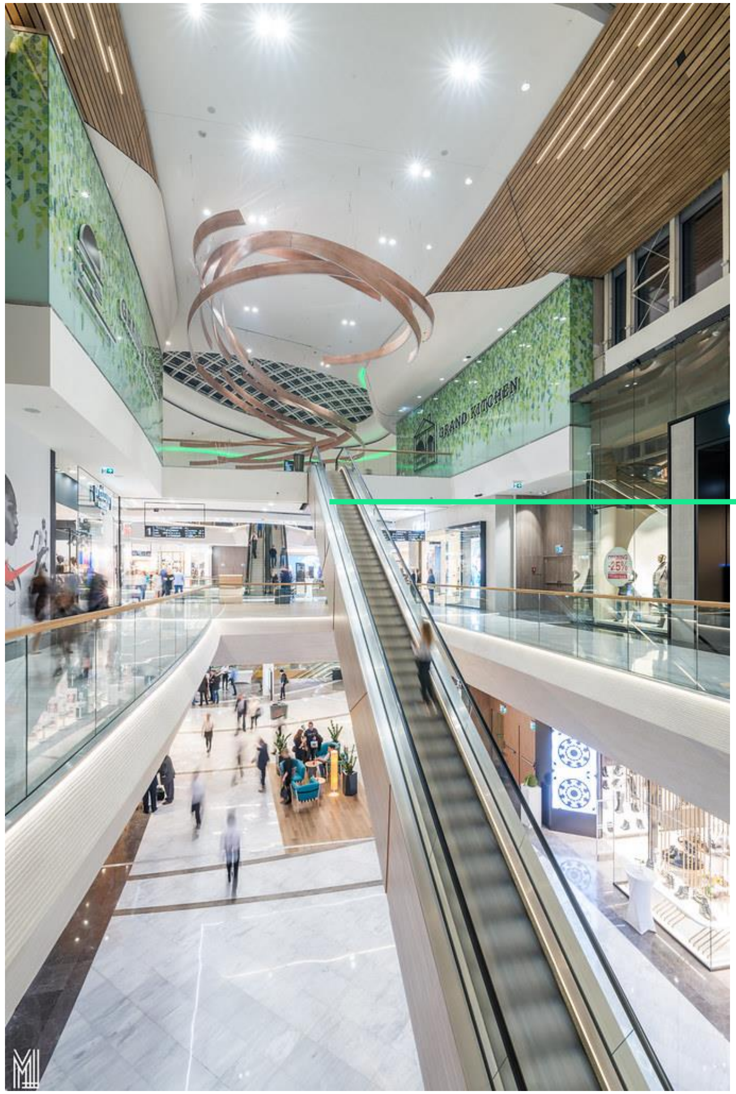
Retail bounces back as restrictions ease

Pandemic-related restrictions applied to retail and leisure space is expected to continue easing in 2022, which will allow footfall and turnovers to recover strongly. The three Baltic states applied various severity measures for the physical retail and leisure space directly correlating with the depth of retail turnover decline and the timing of the footfall & turnover recovery. In 2022 we expect to see a much more consistent and positive outlook.

International travel and office visiting frequency will take more time to return to the pre-pandemic pattern which will continue affecting the speed of recovery of street retail and leisure schemes in the capital cities.

Online sales penetration in total retail sales will continue taking its share. More pick-up opportunities in store, dark chain store expansion and physical pop-ups of online retailers are just a few movements to watch in the longer term.

Physical retail will find new innovative ways to benefit and blend both - experience and convenience into one seamless process. Growing consumer incomes and increasing competition from different channels will continue driving retailers to improve the consumer experience and bring more innovations.



A physical store is going to be perfected by the technology, e-commerce and convenience. Stores help to attract digital sales, and digital sales help physical sales.

07

Residential

Outlook

Lack of product and strong residential demand will maintain the elevated housing prices. Private rental sector to attract institutional investors through forward deals. Increased market supervision from the authorities is expected in the multi-family residential sector.

Trends to watch

01

The current pipeline will not outweigh the demand for individual apartments hence prices for will not decline. Lack of product will create more conversion projects and the alternative housing sector will grow.

02

More taxation and legislation might appear to calm the increasing apartment prices. However, the heavy burden will be placed on the end user, rather than the developer.

03

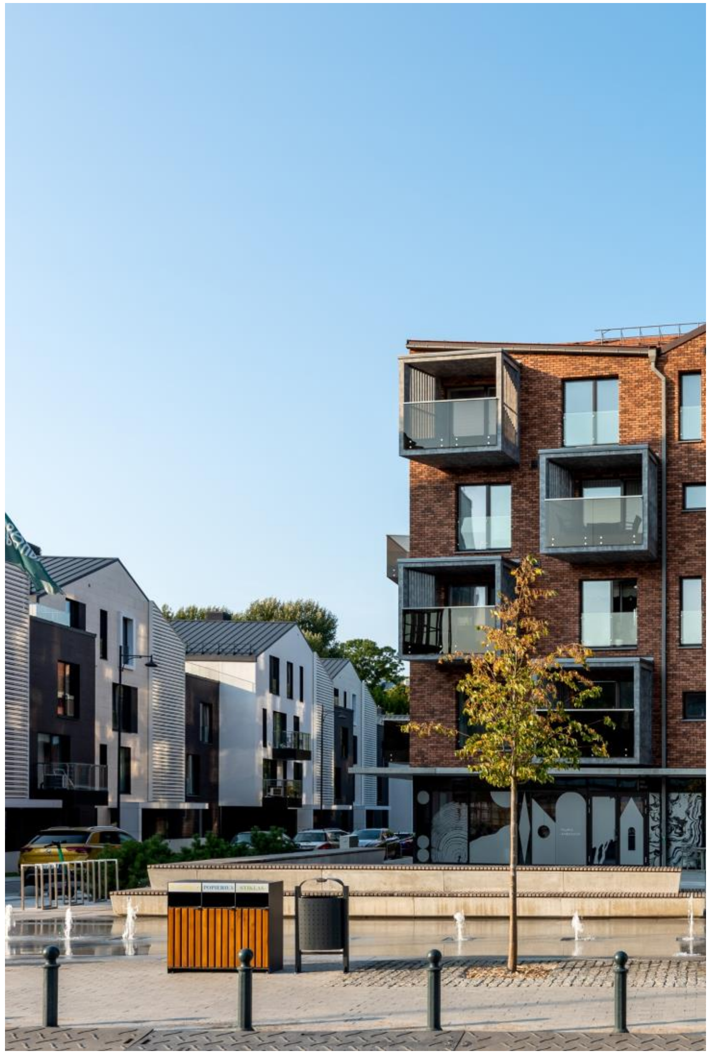
With rent growth falling behind inflation rates, the rental market is expected to show significant gains in the near future.

04

The multi-family residential sector will compete with prime office yields. Lack of supply will push investors into forward agreements.

05

The multi-family rental sector will influence market supervision from the authorities of the sector, creating a professional residential management service in the Baltics.



A playground for local developers

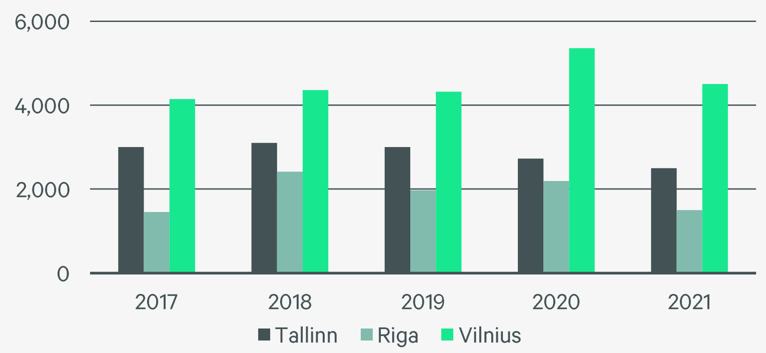
The residential segment in the Baltics is mainly driven by local developers. Although the sector is rapidly growing, it is unlikely that foreign developers will emerge in the market. There is already an increased competition for and a limited supply of attractive land plots, while it would also be rather difficult for a new developer to secure the favour of local buyers.

With a lack of product, the future pipeline will not outweigh the demand for individual apartments. Therefore increasing numbers of residential developments will be pushed outside the city centre and more conversions will start emerging in more preferred locations. Additionally, the alternative housing sector will grow to compensate a lack of residential stock.

Prices skyrocketing, but how far

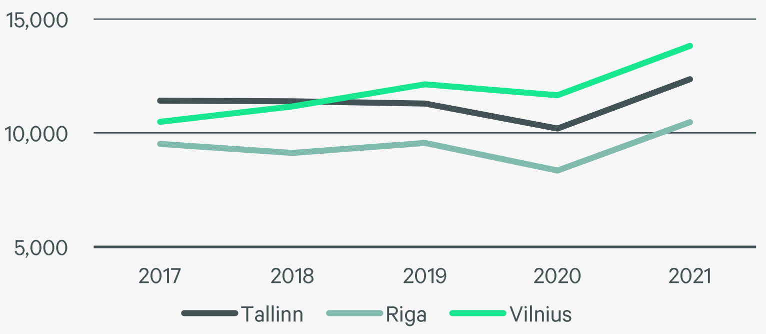
With a lack of residential supply, prices in the Baltics, Vilnius and Tallinn in particular, have skyrocketed. There are more factors which influenced the growth, including but not limited to, delayed construction permits, new infrastructure costs, increasing purchasing power, attractive debt financing environment, and price speculation in the market. Demand for housing in the primary market is so high that developers are no longer able to meet it. There is evidence of acquisitions from plans before achieving practical completion of the building, as well as switching demand even for secondary locations. With customer activity that high, it is difficult to identify at least one factor that could indicate a possible decline in prices.

Figure 10: New apartment supply, capital cities



Source: CBRE Baltics Research

Figure 11: Apartment transactions, capital cities



Source: CBRE Baltics Research

Government intervenes, but how impactful

To mitigate further price growth, Lithuania's government has increased its supervision of the residential market. From the beginning of 2022, Lithuanian citizens will require a larger down payment for second and subsequent housing loans, as the payment has doubled, from 15 to 30%. However, we do not believe that prices are expected to drop unless the supply catches up. Additional taxation will put a higher burden on the end user, as developers will have to compensate for increasing costs in order to achieve required returns. On the other hand, the Estonian and Latvian governments have not stepped in to regulate their residential markets.

Prices yes, but how about rents

With rent growth lacking behind inflation rates, the residential rental market is expected to show significant gains in the near future. The private rental sector will become more noticable, and institutional investors will start investing in this sector in the Baltics.

However, for this market to emerge even faster, market supervision from the authorities should be increased. Currently the Baltics face weak law protection of both landlords and tenants, negligible tax incentives for the investors, and there are too many undecleared lease transactions in the grey economy from the retailers to attract large investors.

Multi-family Rental

Increasing exposure through forward agreements

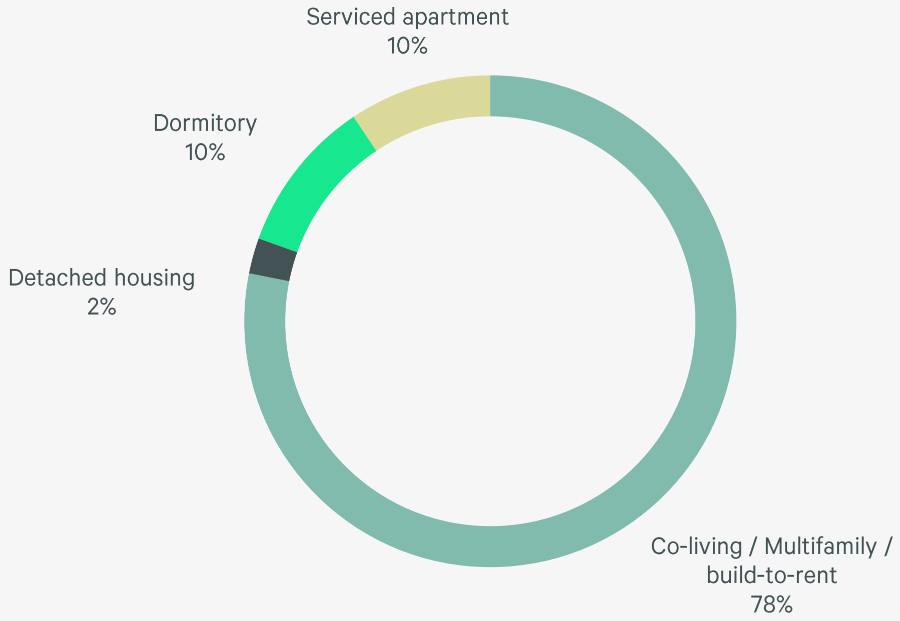
Due to limited pipeline in the market, more investors will be increasing their exposure and appear in the market through forward agreement deals with developers. Forward agreements will become the dominant structure for institutional money to pace after the multi-family residential market.

Multi-family rental competes with office yields

Although there is limited product available in the market, weak market supervision from the government, a sizable grey economy with undeclared lease transactions, and a unique Baltics appetite for home ownership, the outlook for the sector in the medium term is positive. The Baltics are also lacking professional management services for the lease market in the residential sector, which will naturally rise with increasing investment volumes.

With rapidly growing prices in the economy, the private rental sector will catch up with increased rents, which will naturally favour a multi-family sector to emerge. Given the positive outlook from both the developers and the investors, future developments have already and will continue competing with prime office pricing.

Figure 12: Favored multifamily sub-sector



Source: EMEA Investor Intentions Survey, CBRE Research, January 2022

08

Hotels

Outlook

With insufficient domestic tourism, we anticipate hotels to start recovering in line with easing travel restrictions globally. Hotel industry to face staff recruitment and retention issues. Hotels are expected to continue refurbishing the properties for cost-saving reasons. New brand names might enter the Baltic market.

Trends to watch

01

Domestic tourism has been driving the hotel sector during the pandemics. However, with demand being rather scarce and insufficient, hotel operations are expected to recover only with easing travel restrictions world-wide.

02

Pandemic to cause other issues in hotel sector, as recruitment and retention of staff should become a pressing challenge for many operators.

03

We expect new brand names to emerge in the market, both investors and operators. However, financing and liquidity issues are still present for the hotel sector in the Baltics.

04

Different trends have been witnessed during the pandemics, from hotel refurbishments to direct sales or conversions to co-living, office, and rental-apartment schemes. We anticipate further refurbishments for cost-saving reasons and decreasing investment discounts for the hotels.

It is getting better but how quickly

The restrictions have caused prolonged effects on demand and decreased the number of visitors to accommodation facilities by ca. 50% in 2020 in the Baltics, affecting the levels more than the recession in 2008. With restricted traveling, domestic tourists have been driving the sector in the Baltics. However, the increasing number of foreign tourists in 2021 gives reason to believe that with lighter travel restrictions in 2022, the occupancy of the accommodation facilities will increase.

But there will still be challenges

In response to the easing of traveling, hotel operators should remain cautiously optimistic for 2022. However, other non-operational issues, such as recruitment and retention of staff will become a pressing challenge for many.

Although the EU is trying to ensure a more unified policy of travel restrictions, the challenges could be posed by new covid strains, which would force temporary closures or restrictions on travel flows. The timeline of the recovery of the hotel industry goes in line with the control of the global pandemic, which is anticipated only in 2024 – 2025.

Despite the pandemic, operators not present in the region have continued pursuing opportunities, and we expect this to continue in 2022. We anticipate new brand names (both investors and operators) taking over hotels. However, financing and market liquidity are the main issues related to investment attractiveness in the sector.

Tourism has been one of the most affected sectors by the pandemic. However, the investments in the development of hotels were rather active. As the building costs increased, investors were more interested in acquiring accommodation facilities for refurbishing purposes instead of constructing new ones.

Some hotels have been transformed into office and rental-apartment developments in Latvia, and a few have changed hands. Most of the hotels have been refurbished in Estonia, with a few sales of small-scale ones, while the hotel sector in Lithuania has been the most active one. There have been several hotel acquisitions, while some properties have been refurbished and others have completely changed their concept and have been converted into co-living schemes. On the other hand, the premium hotels were also significantly hit by the pandemic across all Baltic members due to reduced business travelling.

The increasing consolidation may bring more investment options to the market as major operators re-evaluate their portfolios and abandon low performing assets. Given the increasing energy prices and weak operational metrics to compensate the rising costs, we expect the hotels sector to continue refurbishing the properties for cost-cutting reasons. We also expect greater flexibility on terms and a push for increased transparency on trading performance. Additionally, we anticipate decreasing discounts in the hotel sector, however it is highly dependent on the hotel performance metrics, location, quality, or other relevant investment or operational factors.

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