CBRE Baltics
PART OF THE AFFILIATE NETWORK

Riga office market heading towards substantial changes

▼ 11.9%
Vacancy Rate

▲ 741k sqm
Total Modern Stock

▼ 54k sqm
Take-up

▼ 2,050 sqm
Completions

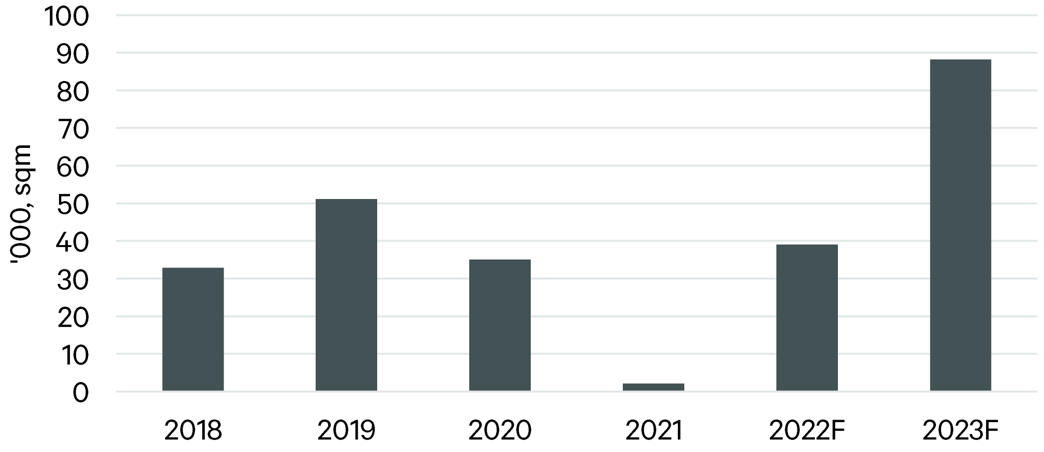
▼ 5.5%
Prime Yield

Note: Arrows indicate change from previous year.

Highlights

- Increasing tenant demands for sustainability, amenities and new working patterns are dictating the need for more suitable office developments.
- Inflation and rapidly increasing construction costs have not strongly influenced commercial and private investors' plans as yet in Riga.
- In 2021, the construction of several projects commenced – Elemental , Mihaila Tala 1, Zeiss offices and Gustavs Business Centre.
- In coming years, Riga's office market will have to attract newcomers to successfully absorb the influx of new office premises.
- Office rent rates remain stable.
- The biggest office investment transactions included EfTEN Real Estate Fund IV's acquisition of Jauna Teika offices and Eastnine's purchase of the office building at Zala 1.

FIGURE 1 New Modern Office Stock Supply 2018 – 2023 Forecast



Source:

Economy

The economy is slowly, but surely recovering

2021 can be characterized as a year when the Latvian economy was getting back on its feet after the 2020 recession. This resulted from an increase in GDP of around 4.8%, estimates from the Central Statistical Bureau.

Resilient demand for important export goods from Latvia continued in 2021, i.e. electronic products and wood, as well as pharmaceutical and agricultural products, resulting in record-high export volumes for the second year in a row.

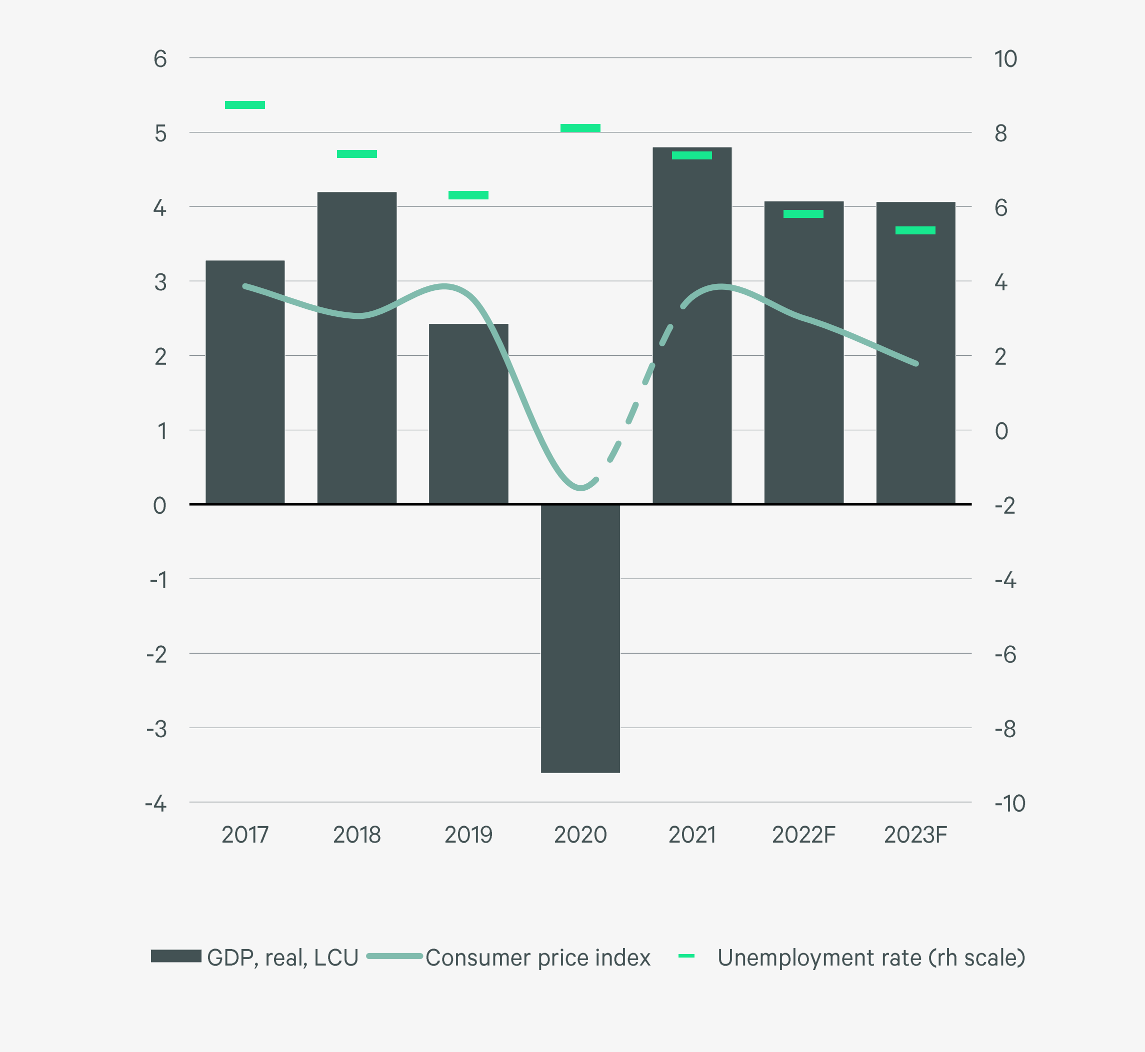
Inflation reached its highest level since 2008.

Inflation was broad-based, with the dynamic being affected by a rise in global demand, the passing on of energy prices to the cost of other goods and services, decisions to increase administered prices, as well as rising global food prices, the effect of disruptions to the global supply chain on the price of industrial goods and increases in wage expenditure on production costs. Latvia's annual inflation rate averaged 3.3% in 2021, remaining below the EU average, with the country experiencing the slowest price increase in the Baltics.

If inflation in construction costs had been driven, in recent years, mainly by the annual increase in labour costs, unusually rapid and sharp price increases were recorded for several construction materials in 2021, leading to an increase in annual construction costs of ca. 7%. These fast-growing construction costs have not appeared to have any influence on the plans of commercial and private investors in Riga.

Despite the restrictions on workers without a suitable Safe Pass, the annual rate of unemployment decreased by 0.8 pp to 7.3% at the end of 2021. Furthermore, an increase in average wages of over 7% was recorded in 2021. This was influenced significantly by the previously announced decisions on raising the minimum wage, as well as the wages of medical and teaching staff.

FIGURE 2 GDP Growth, inflation and Unemployment Rate



Source: Oxford Economics, Central Statistical Bureau, CBRE Research

Supply

Growth rate in Office Supply in 2021, the lowest in last 8 years

Only one office project was commissioned in 2021, marking the lowest developer activity in the last 8 years. But, despite increasing construction costs, Riga's office market has gained momentum with 126,000 sqm of modern office premises currently under construction and more than 130,000 sqm in the planning stage. This will help in renewing Riga's aging office stock significantly. By the end of 2023, Riga's office stock will grow by 17%, standing at 867,000 sqm.

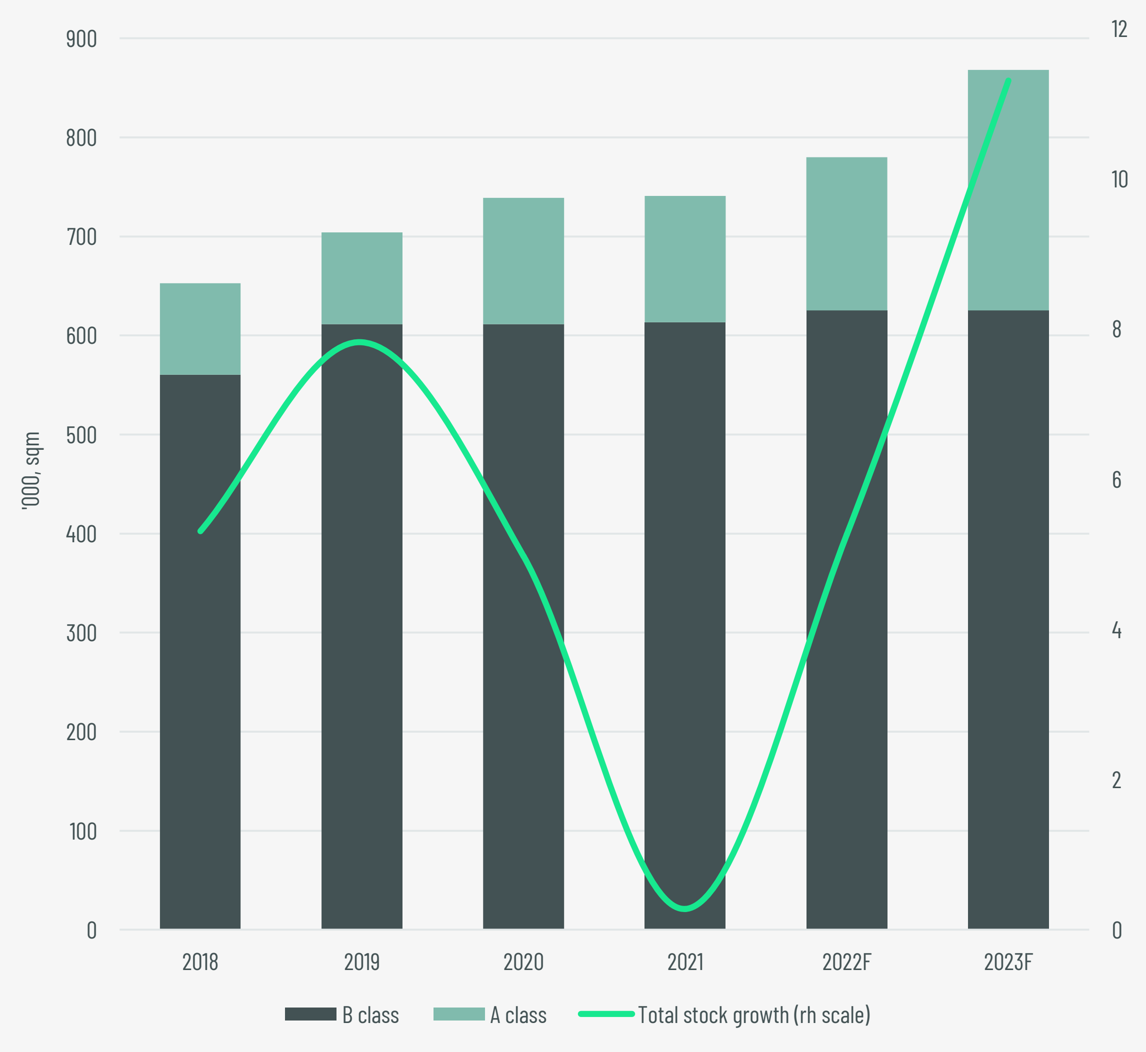
Developers have chosen different areas in the city for their developments in response to occupier demand . In 2021, the construction of several projects commenced - in the Skanste area, there was Kapitel with Elemental (20,500 sqm) and Pillar with Mihaila Tala 1 (12,000 sqm), Mukusalas Biznesa Centrs in Pardaugava is building the Zeiss Offices (4,200 sqm) and Galio Group started on the construction of the Gustavs Business Centre (11,000 sqm) in the VEF/Teika area, which had been pre-let to SEB GBS.

Several clusters have been chosen for the development of planned office complex projects. Estonian developer Hepsor is planning to develop an ambitious office complex called Krasta City (17,000 sqm) on the bank of the River Daugava in the Krasta Street area. Vastint Latvia has chosen the quieter area of Riga centre for the Magdelenas kvartals (9,660 sqm) office development and will continue to develop Business Garden Riga in Pardaugava. Eastnine is planning to start construction on their unique wooden office building, The Pine (15,200 sqm), in 2022.

Sustainability is increasing in importance

31% of the existing stock of office buildings have LEED or BREEAM sustainability certificates. At the same time, 88% of the buildings under construction will have BREEAM or LEED sustainability certificates. Latvia must comply with the Paris Agreement and the New EU Climate Act, which set the EU target for reducing greenhouse gas emissions by at least 55% by 2030 (compared to 1990). Increasing energy prices make sustainable developments even more appealing, and older office buildings will require investment to transition and comply with sustainability needs and policies.

FIGURE 3 Riga Modern Office Stock



Source: CBRE Research

Demand & Absorption

Office occupiers will face challenges in adapting to the new normal

The take-up in 2021 was 54,000 sqm or ca. 46% more compared to the previous year. Two pre-lease deals are the main reason for the increase – SEB GBS's decision to relocate to the Gustavs Office Building and SEB Bank's announced move to the Satekles Business Centre developed by Linstow. While the pre-lease deals are a positive sign, Riga's office market will have to attract newcomers to successfully absorbē the influx of new office premises over the coming years.

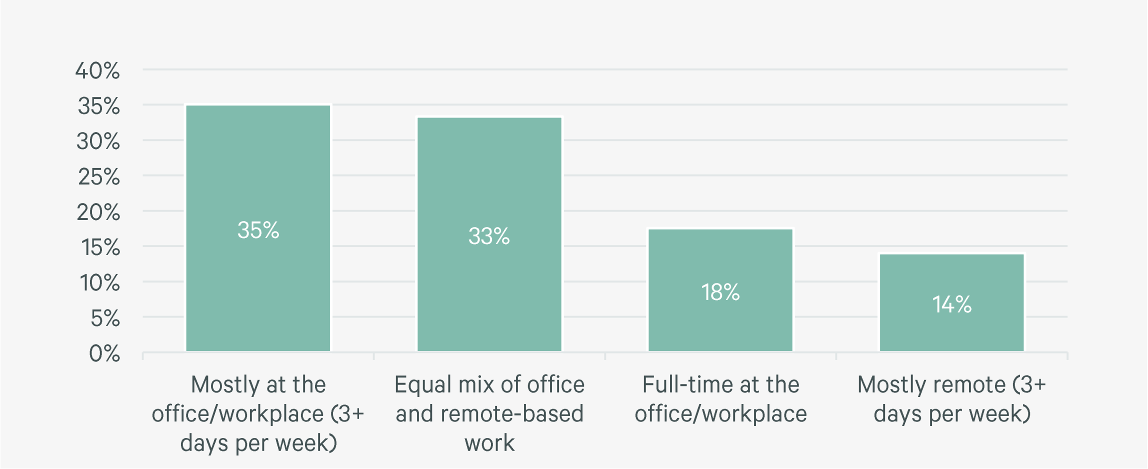
More sublease options were available in the market during the second year of the pandemic, but the impact of sublease deals on take-up was minor. We do not expect an increase in sub-lease options in the near future.

Occupiers are still trying to calculate their required office space once the Covid-19 situation stabilizes, when companies will start welcoming employees back to their offices. According to the CBRE Baltics Occupier Survey, 82% of the Riga tenants who responded are planning to implement hybrid work at their offices to some extent. Companies will have to adapt their current office space to the new working models and dedicate more areas for collaboration and activity-based functions. Older office buildings could struggle to offer flexible solutions to their tenants, and relocation to new office projects will be considered by occupiers.

Vacancy

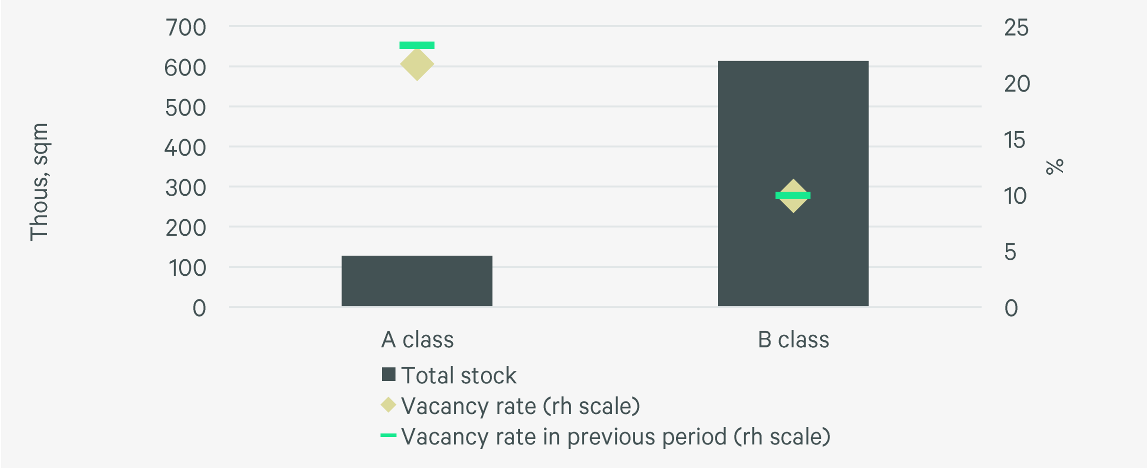
Riga's office vacancy held steady in 2021 compared to 2020, at 11.92%. This is equivalent to nearly 90,000 sqm of vacant space. We expect that the vacancy rate will increase in 2022/2023, as more than 120,000 sqm of high-quality office space currently under construction will be delivered to the market. Although the lowest vacancy rate is currently in B2 class (7.90%) office buildings, this class will be under pressure in the future as tenants will be putting more emphasis on building sustainability and advanced technical parameters which favours new office projects.

FIGURE 4 Which best describes the cultural norm in a steady state that your organisation aspires to with workplace



Source: CBRE Research, Occupiers Survey

FIGURE 5 Vacancy rate by Office Class



Source: CBRE Research

Office Rents

Headline rents in recently built projects and in projects under construction have upward pressure due to increasing construction costs. Prime rent stands at 17 EUR/sqm/month. Lower class (B2) office buildings will have to offer extra incentives to potential tenants and a decrease in rent will be one of them. We can already see that vacant lower-class premises are facing difficulties in new tenant attraction.

The achievable headline rent in A class office buildings ranges between €14.00 – 17.00/sqm/month, and from €8.20 – 15.00/sqm/month in B class office budlings. Taking the increasing competition between landlords into account, effective rent may be lower by 5 – 10%, depending mainly on the length of leases.

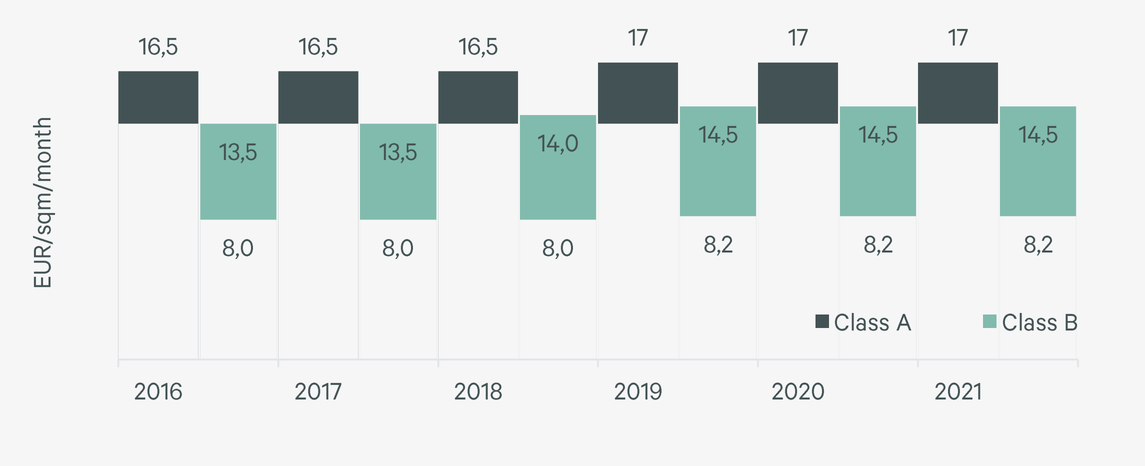
Investment & Transactions

Total investment volume increased by 77% compared to 2020, with a 41% increase compared to 2019, reaching almost 1,6 bn EUR. For the first time in the last 5 years, less than 25% of total investment volume in 2021 was generated by the office sector. This is a trend due to the grand retail investments in 2021, with the office sector still producing almost 160 mln EUR.

The biggest office investment transaction in 2021 was EfTEN Real Estate Fund IV's acquisition of Jauna Teika, where the Hanner Group sold their development of ca. 60,000 sqm office space for 131 mln EUR. Eastnine's purchase of the office building in Riga at Zala 1 was another remarkable transaction that took place in 2021.

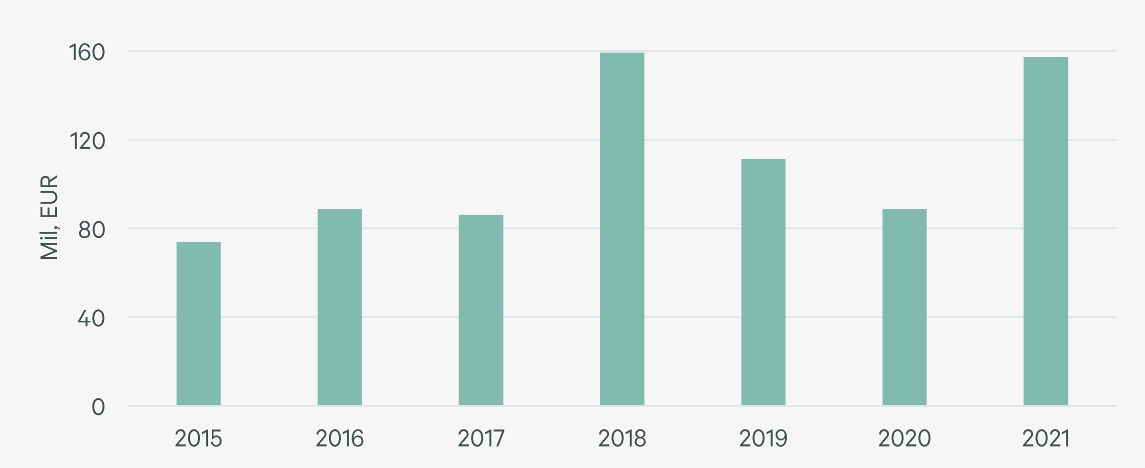
On average, prime European and Baltic CBD office yields have hardened annually. The prime yield for offices in Riga compressed to 5.5 % in 2021, while the secondary also compressed by 0.25 bp, compared to late 2020, and remains at 7.25%.

FIGURE 6 Rent Rates by Office Class



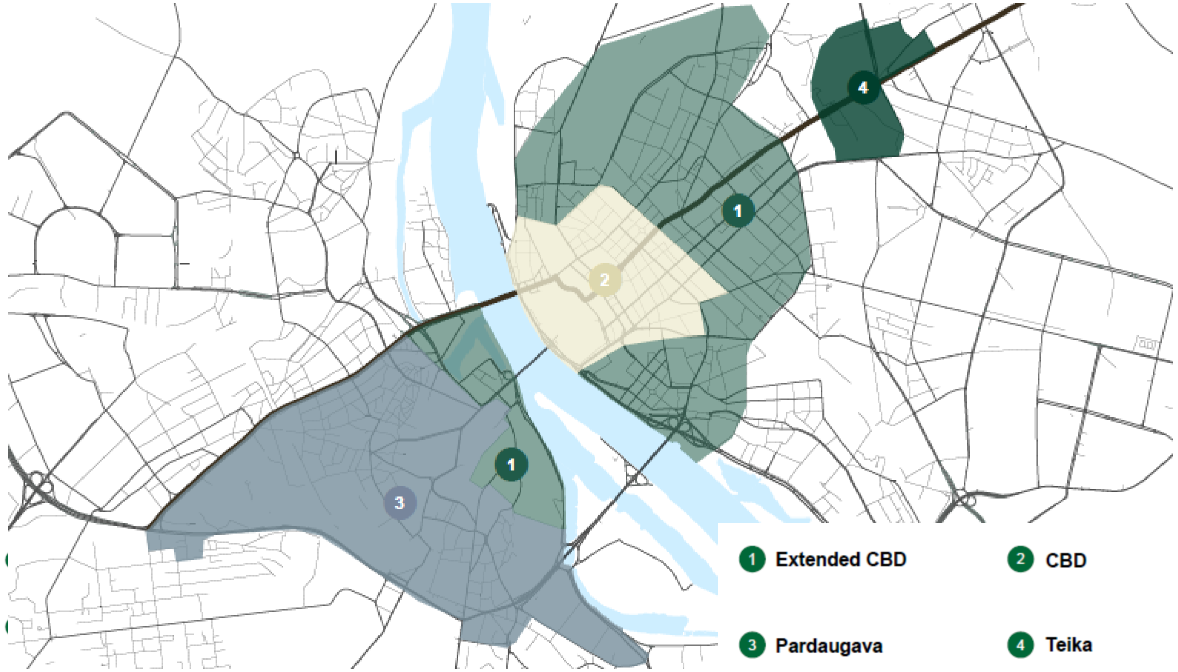
Source: CBRE Research

FIGURE 7 Office Investment Volumes, 2015-2021, mil EUR



Source: CBRE Research

Market Area Overview



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