All Sectors

Market Outlook 2022 H1

REPORT

BALTIC
REAL ESTATE

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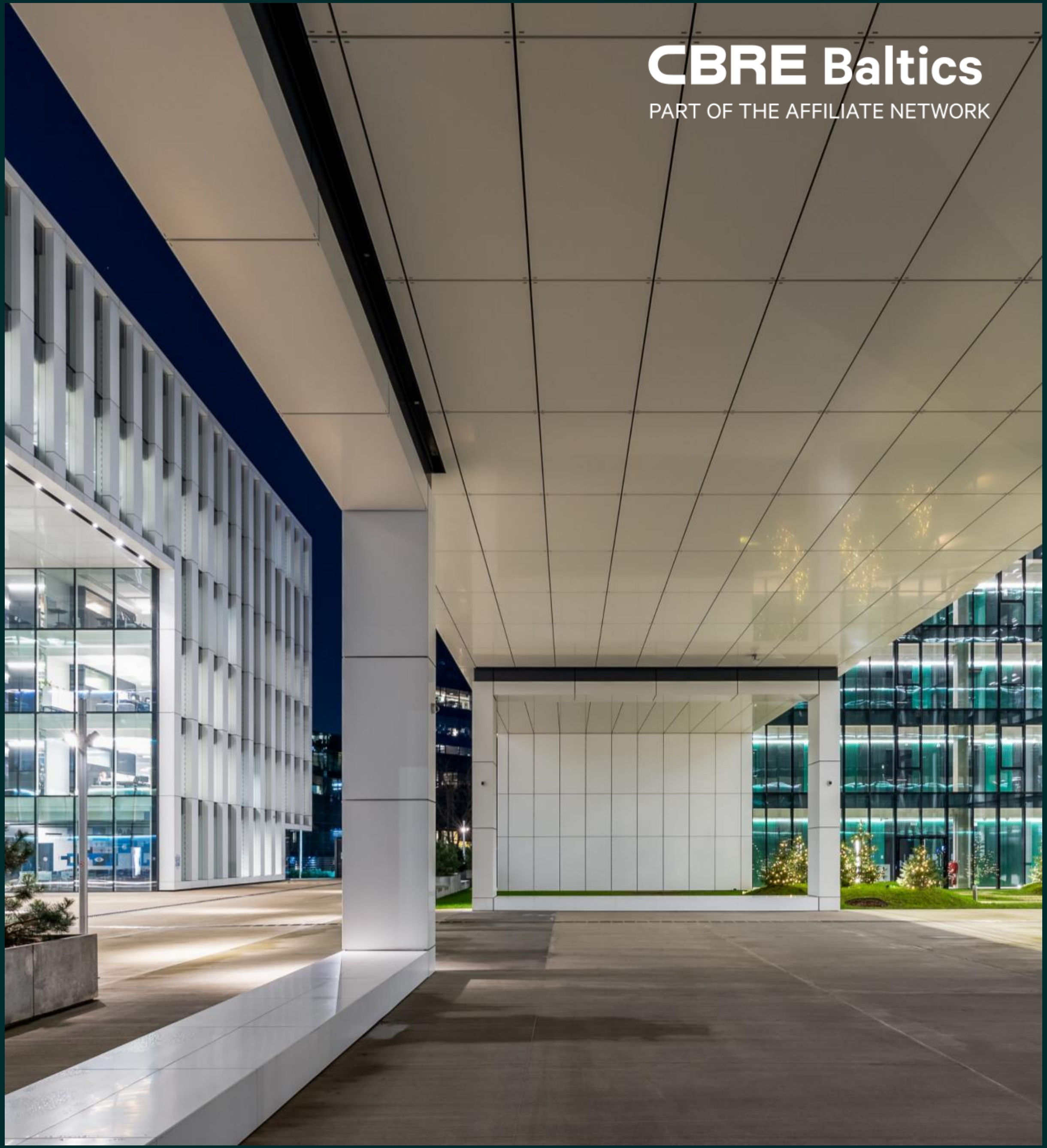
RESEARCH



Economic Suppression or Recession?

At the beginning of 2022, CBRE Baltics forecasted a recovery path for the Baltic economies, with the pandemic entering the endemic stage. However, given the geopolitical tensions, the awaited post-pandemic recovery is likely to progress to a recession.

- Baltics economies demonstrated resilience over the pandemic but are now threatened by recession.
- Quality offices: challenges in disposing of tertiary space and acquiring prime space.
- Retail sales seized the post-pandemic opportunity, and retail turnover increased.
- Development volume of modern industrial speculative stock is now scarce across the Baltics.
- Fundamentals that support rental residential sector growth are becoming increasingly important.

The economic backdrop is becoming more challenging in the Baltics, and a period of a mild recession is becoming more realistic. Commercial real estate reacts to the uncertainty, as well. Therefore, an intense run for quality assets has arisen. Challenges especially appear in acquiring prime space.

Over H1 2022, geopolitical tensions caused tailwinds in the economy. As a result, the Baltics, whose economies demonstrated resilience over the pandemic, faced more challenges. High uncertainty due to geopolitical conflicts, re-accelerating COVID-19 cases, rapidly increasing energy costs, and continuing supply chain disruptions are expected to support the upward pressure on rents in the short term, especially for the prime assets.

A low-interest rate environment during the pandemic has supported commercial real estate pace across the Baltics, as well as improved affordability in the housing sector. However, the hikes in long-term interest rates are now being driven by the European Central Bank, reducing the pandemic-related quantitative easing programs and handling the peaking inflation in 2022.

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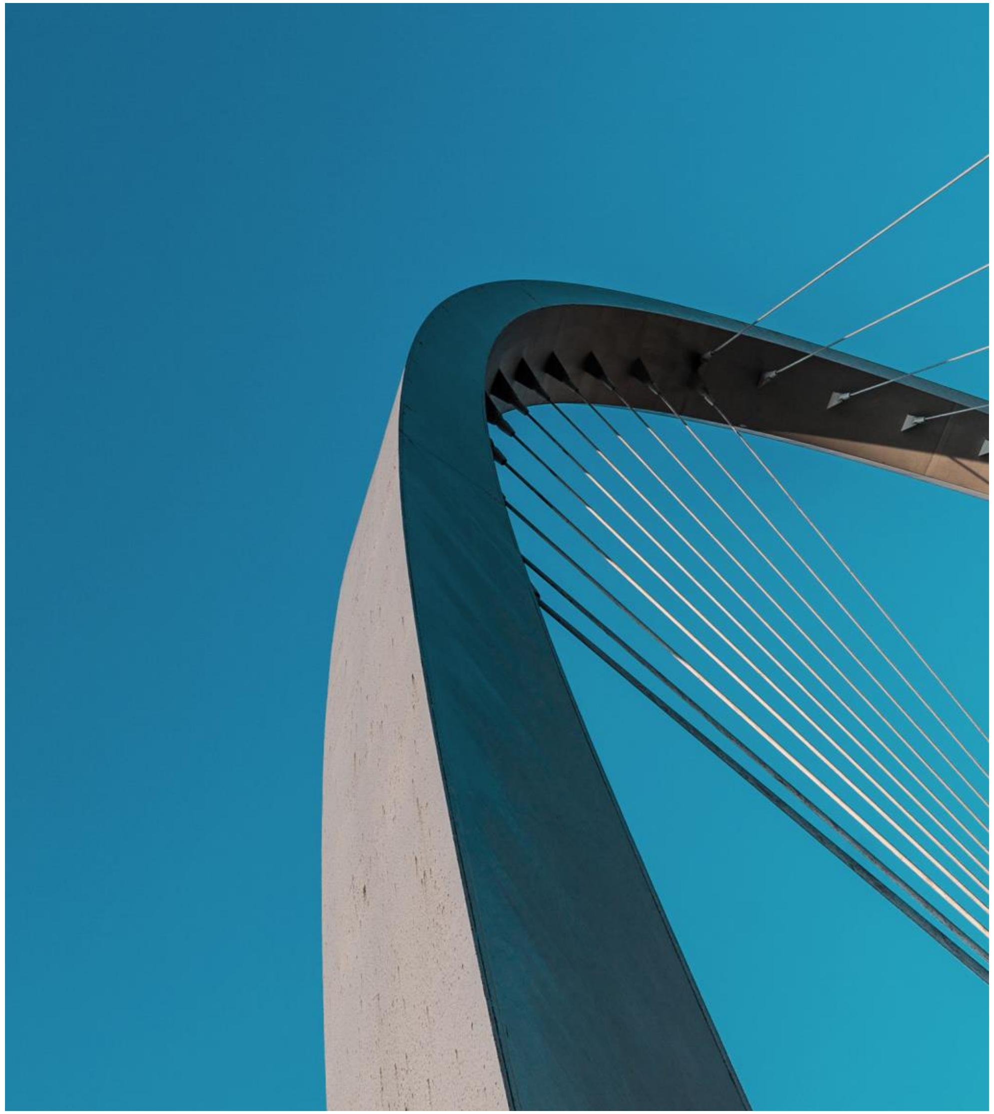

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01

Macroeconomics

Will high inflation, geopolitical tensions, supply chain disruptions, and pandemic lead the Baltic economies to recession?

Baltic Outlook

The start of 2022 was optimistic as the recovery from the pandemic set the markets on the high tide. Yet, geopolitical tensions, soaring prices, and continuing supply chain disruptions have imposed limits on the robust economic growth. Although economic slowdown seems to be inevitable, it is not expected to be sharp and long. However, the market will remain volatile for some time.

GDP

After a substantial increase in Q1 2022, the Baltic economy suppressed its growth in Q2 2022. As a result, the annual growth rate has lessened. GDP predictions for the year have been volatile, falling from implacable growth of ca. 4-6% at the beginning of 2022 to the current forecasts of 2-3% as of end-H1 2022.

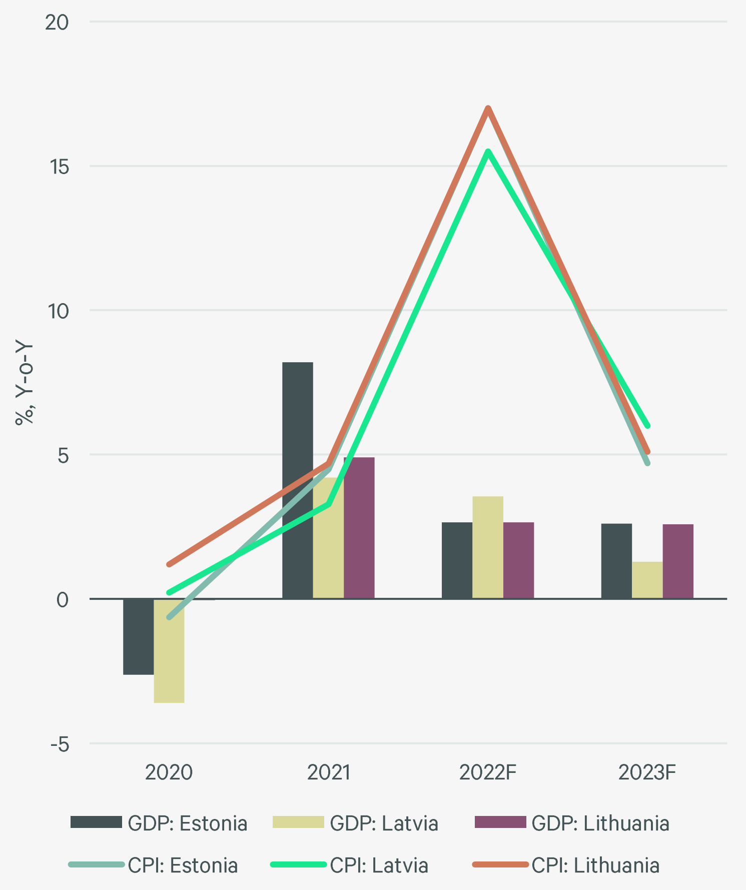
Inflation

Inflation in the Baltics is the highest in the EU, hitting above 20% annual price increase at the end of June. Inflation is mainly impacted by the steep rise in energy, gas and housing-related costs. Economists anticipate around 13-15% annual inflation at the end of 2022. The prognosis for the next couple years is also inflated, staying above the formal target of 2%.

Interest Rates

In July, the ECB increased interest rates after 11 years to cool rampant inflation in the Eurozone. The higher cost of money should lead to lower consumer spending and higher mortgage rates. Yet, some economists say that higher interest rates may fail to combat inflation, since its driving force is mainly hugely high energy prices.

Figure 1: GDP and CPI Growth Forecast, Baltics, 2020-2023F



Source: Oxford Economics, European Commision, CBRE Research

Exports & Imports

All Baltic countries saw export and import volume growth on year in H1, ca. 30% and 37%, respectively. However, the pace could start to slow down in the second part of the year due to more sanctions and a possible slowdown of the economy.

Labour Market

While the average salary continues growing in the Baltics, real wages started to decline in H1 2022 due to rising inflation. On the other hand, the unemployment rate kept dropping (to ca. 6% over H1 2022), reflecting the high demand for workers. The unemployment rate will slightly increase as the economy slows.

Tourism

Tourist activity in the Baltic capital cities H1 2022 increased 4 times compared to 2020. Local tourist numbers have also increased compared to 2019 but the total number is not there yet. Nevertheless, the impact of geopolitical tensions has shaped the popularity of the Baltics as a destination for inbound tourism.

Business & Consumer Sentiment

The economic sentiment has lately been deteriorating due to worsening expectations for personal and national financial stability. The metrics have plunged, fuelled by frustration over high prices, standing below the EU average. Yet, retail and service confidence remained positive in H1 2022, showing the consumer's ability to continue spending. We anticipate a retail consumption contraction with the start of the heating season.

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02

Investment Market

How will investors revise their portfolio composition to handle the economic downturn cycle?

Highlights

01 INVESTMENT VOLUMES

Capital investments in the Baltics reached EUR 588 million in H1 2022, with Estonia leading the region. Volumes were higher compared to the respective period last year but noticeably lower than in H2 2021.

02 DOMINANT ASSET CLASSES

Shopping centres and retail big-boxes with strong anchor tenants and long leases were, year to date, the primary investors' target in the region.

03 YIELDS

Yields have remained stable in all sectors during the last half year, with the compression witnessed in the industrial and logistics sector.

04 EUROPEAN INVESTMENT TRENDS

Strong real estate investment volume in Europe masks the downturn of investor sentiment amid the increasing cost of capital and high inflation.

05 BALTIC OUTLOOK

Baltics witnessing a slowing investment pace, and with increased uncertainty in the political and economic context, lower real estate investment activity in the region throughout 2022 is expected.

Prime Yields

TALLINN / RIGA / VILNIUS

5.5 / 5.5 / 5.0

Offices - Prime CBD, %

7.0 / 7.25 / 7.0

Shopping Centres – Prime, %

6.5 / 6.5 / 6.25

Industrial – Logistics, %

5.0 / 5.25 / 5.0

Multi-Family Rental - Prime Capital City, %

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Investment Volumes

Capital investments across the Baltics reached EUR 588 million in H1 2022, with Estonia leading the region at 36% of total investment volume, followed by Lithuania at 34% and Latvia at 30%. Baltic investments were 13% higher than for the respective period of the previous year, 47% lower compared to H2 2021, yet 150% higher than a 5-year average of the respective periods.

Dominant Asset Classes

Core asset classes continue showing robustness in the region, with retail already leading the investment sector for a fourth consecutive quarter. H1 2022 investments in the retail sector comprised 39% of the total investment volume, indicating a relatively broader retail asset availability in the market compared to other asset classes.

Shopping centres and retail big-boxes with strong anchor tenants and long leases are, to date, the primary target for investors in the region in 2022, as more than 80% of total Baltic retail stock transacted in H1 2022 involved similar schemes. While Lithuania and Latvia witnessed similar capital flows into retail assets of 40% each, Estonia lagged behind its peers with the remaining 20% of total investments in the sector.

The industrial sector comes second in H1 2022, comprising 23% of total investment volume, followed by offices at 20%. The most popular destination for capital flows into industrial and logistics assets in H1 2022 was Estonia, which comprised 70% of the sector's total investments. Meanwhile Lithuania and Estonia shared equal investment volumes, together comprising 88% of total invested capital in the office market during the period, followed by Latvia at 12%.

Figure 2: Investment Volumes and Shares in Baltics, H1 2022 vs. H1 2021

RETAIL	39%	98M Y-o-Y Change
INDUSTRIAL	23%	-56M Y-o-Y Change
OFFICE	20%	52M Y-o-Y Change
MIXED USE	6%	29M Y-o-Y Change
HOTEL	3%	-40M Y-o-Y Change
RESIDENTIAL	3%	-6M Y-o-Y Change
OTHER	6%	27 M Y-o-Y Change

Source CBRE Baltics Research

Note: *Other* includes Alternative and Healthcare sectors

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With limited private rental sector stock, the region witnessed several forward agreements between the investment funds and residential developers in the multi-family sector. Yet, the volumes are too modest compared to other core sectors.

Yields

Yields have remained stable in all sectors during the last half year, with compression (of 25 bps) witnessed in the industrial and logistics sector.

European Investment Trends

Investment into European real estate showed robust figures amid economic and political uncertainty in the region. European investment (incl. CEE and SEE regions) volumes have increased by 20% compared to the similar period last year – the European market (excl. CEE and SEE) even welcomed the strongest H1 ever. Offices accounted for nearly a half of all investments.

Yields for core sectors have been compressing for the last half a year but are expected to become weaker for months to come. During this period of increased uncertainty, high investment volumes mask the downturn in investor sentiment. The worsening sentiment is associated with the regional geopolitical tensions and the weak economic outlook of high inflation and increased cost of debt, where buyers and sellers have started adopting a wait-and-see strategy.

Even if investors are focused on prime sustainable assets and competition for these remains high, the main issue in the CEE & SEE region is related to the limited new supply under construction with delivery in the following 12 months changing the focus towards lower quality assets with the potential of refurbishment to be brought to sustainable standards.

CBRE, *CEE Real Estate Investment Volumes*, Q2 2022

Baltic Outlook

The Baltics is witnessing a slowing investment pace compared to the record highs of 2021, and with increased uncertainty in the political and economic context, we anticipate lower real estate investment activity in the region throughout 2022.

Interest rate hikes by the ECB, further making financing more expensive, will likely widen the average yields across the sectors. However, with one of the highest inflation rates in Europe, competition for prime assets in the Baltics will persist and, therefore, the yields for core assets are expected to remain the same or even compress further.

These unprecedented times have slowed the plans of foreign investors for employing capital in the Baltics. Hence, the region continues to show a strong and growing domestic investor demand, as more than 80% of total investments came from local players in H1 2022 (H1 2021: 53%). We expect a similar trend to persist throughout 2022.

As a result of decreasing product availability in the region and in search of higher liquidity, local investors started exploring and investing in the broader CEE region (mainly Poland). Baltic investors are expected to continue exploring the wider CEE region, with priority still maintained for the domestic market.

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03

Office Market

How are prices and workplace solutions revised to accommodate the office demand influx?

Highlights

01

MARKET OVERVIEW

The office market has reactivated itself in all three Baltic countries during H1 2022: under construction stock expanded, vacancies contracted, and take-up remained robust.

02

OFFICE LEASING TERMS

Geopolitical tensions and acclimatization to the pandemic sharpened the influx of demand. Companies are now more actively considering furnished solutions ready for immediate relocation.

03

SUSTAINABILITY

The sustainability certification (BREEAM, LEED, WELL or Fitwel) has already become a standard, as the number of certified buildings grows.

04

EUROPEAN TRENDS

Most markets are seeing two-speed trends, with low availability in central submarkets and in new buildings, and much higher vacancy rates in peripheral office districts.

05

BALTIC OUTLOOK

Due to active projected deliveries, the total modern stock should reach the one million sqm mark for Tallinn and Vilnius by the end of 2022.

Baltic Office KPIs

TALLINN / RIGA / VILNIUS

17.5 / 17.0 / 18.5

Prime Rent, €/sqm/mth

936 / 741 / 937

Total Stock, thous. sqm

5.0 / 10.9 / 6.3

Vacancy Rate, %

25 / 28 / 50

Take-Up, thous. sqm

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Market Overview

Supply

The office market has reactivated itself in all three Baltic countries during H1 2022: under construction stock expanded, vacancies contracted, and take-up remained robust.

In Tallinn and Riga, no new projects were introduced to the market in Q2 2022, marking the second quarter in a row with an absence of new deliveries. However, in Vilnius, almost 45,000 sqm was commissioned over H1 2022. Construction market forces lead to some completions for new offices being postponed.

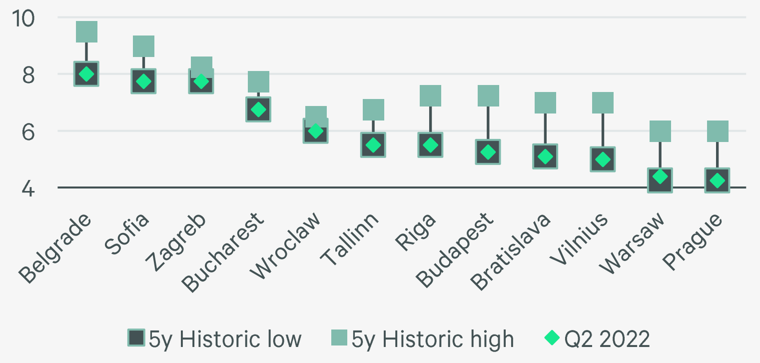
The amount of modern under-construction office space is unprecedentedly high in all the Baltic capitals (179.7, 137.2, and 203.4 thous. sqm in Tallinn, Riga, and Vilnius, respectively).

Demand

The demand for new energy-efficient A-class offices remains high, but many occupiers are being forced to lower expectations due to insufficient new supply. This is supported by the fact that, like most of the A-class office buildings, many new B-class office projects are already leased out before being opened.

Occupiers are looking to optimize their offices and adapt to increased hybrid working. Tenants, whose leases are about to expire, are more actively looking for relocation opportunities, as most of the existing stock does not offer reasonable downsize options. Several sublease deals were recorded in Q2. This trend is expected to continue in H2 2022.

Figure 3: Prime Office Yields, Baltics & CEE, Q2 2022, %



Source: CBRE Baltics Research

Figure 4: Selective Sizeable Pipeline Developments for H2 2022

Project name	Country	City	Developer	Class	GLA, sqm
Cyber City	LT	Vilnius	Sparta	B	35,000
Core (II stage)	LT	Vilnius	Baltijos Gildija	A	29,400
Alma Tominga House	EE	Tallinn	Mainor	A	20,000
Business Stadium North East (III stage)	LT	Vilnius	Hanner	A	15,500
Verde I	LV	Riga	Capitalica Asset Management	A	15,000

Source: CBRE Baltics Research

Vacancy

Overall, the market is sending confident signals, with vacancies declining in the Baltics (-24%, -13%, and -42% YoY change in Tallinn, Riga, and Vilnius, respectively).

A-class stock is particularly in demand, with substantial space secured for under-construction buildings. Vacancy for A-class premises ranges from ca. 3% in Vilnius to around 4% in Tallinn, and ca. 9% in Riga.

Vacancies are expected to decrease further, as not many sizeable tenants are exercising lease expirations, and most of the premium under construction stock is already pre-leased.

Market Rents

The sense of an approaching economic slowdown is exerting pressure, especially on prime rents. During H1 2022, the prime rent climbed to 17.00-18.50 EUR/sqm/month in the Baltic capitals. Rent prices in existing A-class office buildings should remain slightly elevated, with increasing construction costs and, thus, extra investment in the standard office fit-out. The B-class rents are expected to remain stable.

We expect to experience the further upward pressures, especially given that some projects will be delayed for an unspecified time because of peaking construction costs. Rising rents unpleasantly surprise local tenants but are less explicitly referenced by international occupiers. Most tenants are ready to pay higher rents for more sustainable and technically advanced projects.

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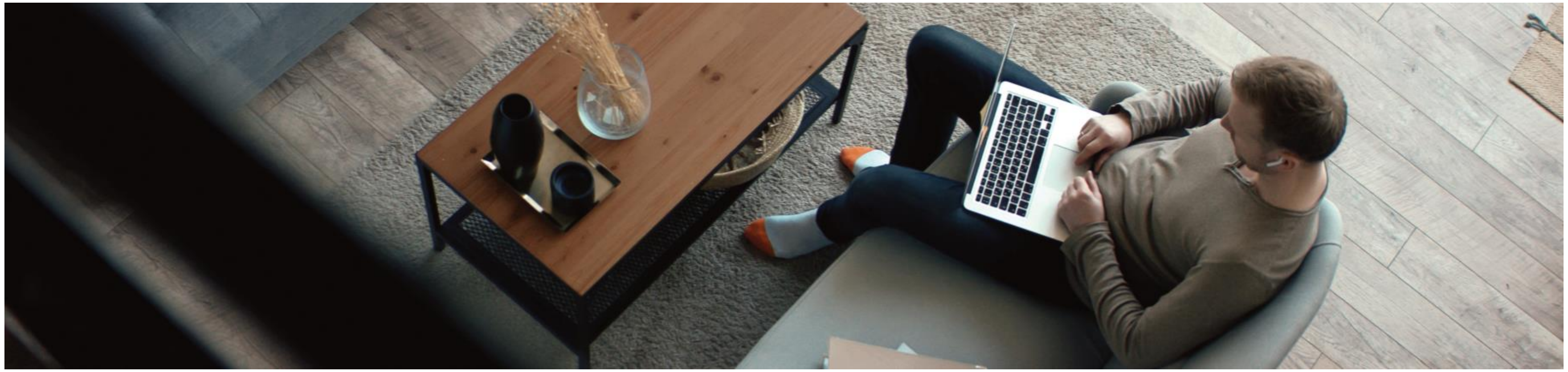
Office Leasing Terms

Remote working is supported by attractive conditions in the Baltics. *NordLayer* has listed Lithuania in the top-5, Estonia among the top-10, and Latvia in the 21st place for remote work locations around the world.

The rule-of-thumb for relocation after signing the lease was commonly considered ca. 4-12 months. However, geopolitical tensions and acclimatization to the pandemic sharpened the influx of demand and shaped traditional office leasing terms. Companies are now more actively considering furnished solutions ready for immediate relocation. At the same time, we are seeing the rise pre-leases. Such sentiment is expected to be evident by year-end 2022.

- Due to the shrinking leasing opportunities, the upward pressure on rents is already present in all workplace solutions: shared-service solutions and traditional offices. Asking rents were revised in Q2 2022 as a result of the low vacancies, increased maintenance costs, and indexation for ongoing leases.
- Rising fit-out costs also impact on incentive packages, that are under downward pressure, resulting in effective rental growth.
- Looking at traditional offices, there is no prime space available immediately for sizeable enquiries, especially in the Vilnius and Tallinn markets. Fast decision-making needs to be executed among smaller tenants, as well, since vacant premises tend to be quickly leased out.
- More occupiers will be ready to sign pre-leases 18-24 months prior the commissioning of the building to cater for the expansion plans.



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> Active demand further drives the need for quality workspace. The active marketing campaigns of BREEAM, LEED, WELL, and Fitwel are no longer a nice-to-have attribute but rather a requirement that tenants regard highly for their workspace.

Ieva Vitaityte
Manager, Research & Consultancy

Sustainability

- The sustainability certification (BREEAM, LEED, WELL or Fitwel) has already become a standard, as the number of certified buildings grows.
- Certification of buildings plays a crucial role when attracting and retaining international and institutional real estate investors, because they focus on sustainable buildings to secure investment liquidity and returns in the long-term.
- Office tenants already consider sustainability, but there are just a few tenants for whom certification would be a deal breaker. Location, price, developer, and size are still driving forces.
- Foreign sizeable occupiers are more interested in building certificates and real estate sustainability practices, because they have global corporate sustainability guidelines to follow.
- Certification standards are expected to become stricter and more complex, requiring more advanced technologies, better solutions, and better materials.

E

Renewable energy, pollution, land contamination, waste, energy consumption, materials, EV charging spots, etc.

S

Working conditions, mental and physical health, community, safety, amenities (showers, changing rooms), etc.

G

Sustainable financing, anti-money laundering, ESG clauses in leases, cybersecurity, stakeholder engagement, etc.

European Trends

- Financial services companies find the most value in using flexible office space as a bridge to long-term solutions, to accommodate remote workers and to test new markets.
- EMEA is still reported to have low office attendance, compared to Asia where in person work has returned to pre-pandemic levels.
- European vacancy rates are likely to stabilize across core markets during 2022 as tenant controlled 'grey' space is withdrawn, development pipelines become majority pre-let, and occupier demand continues to gather pace.
- Most markets are seeing two-speed trends, with low availability in central submarkets and in new buildings, and much higher vacancy rates in peripheral office districts.
- Lease incentives for prime space will be gradually withdrawn as demand is most resilient for CBD locations in mixed-use environments and prime rents reach near-record highs.
- Organizations anticipate greater office attendance in 2022.

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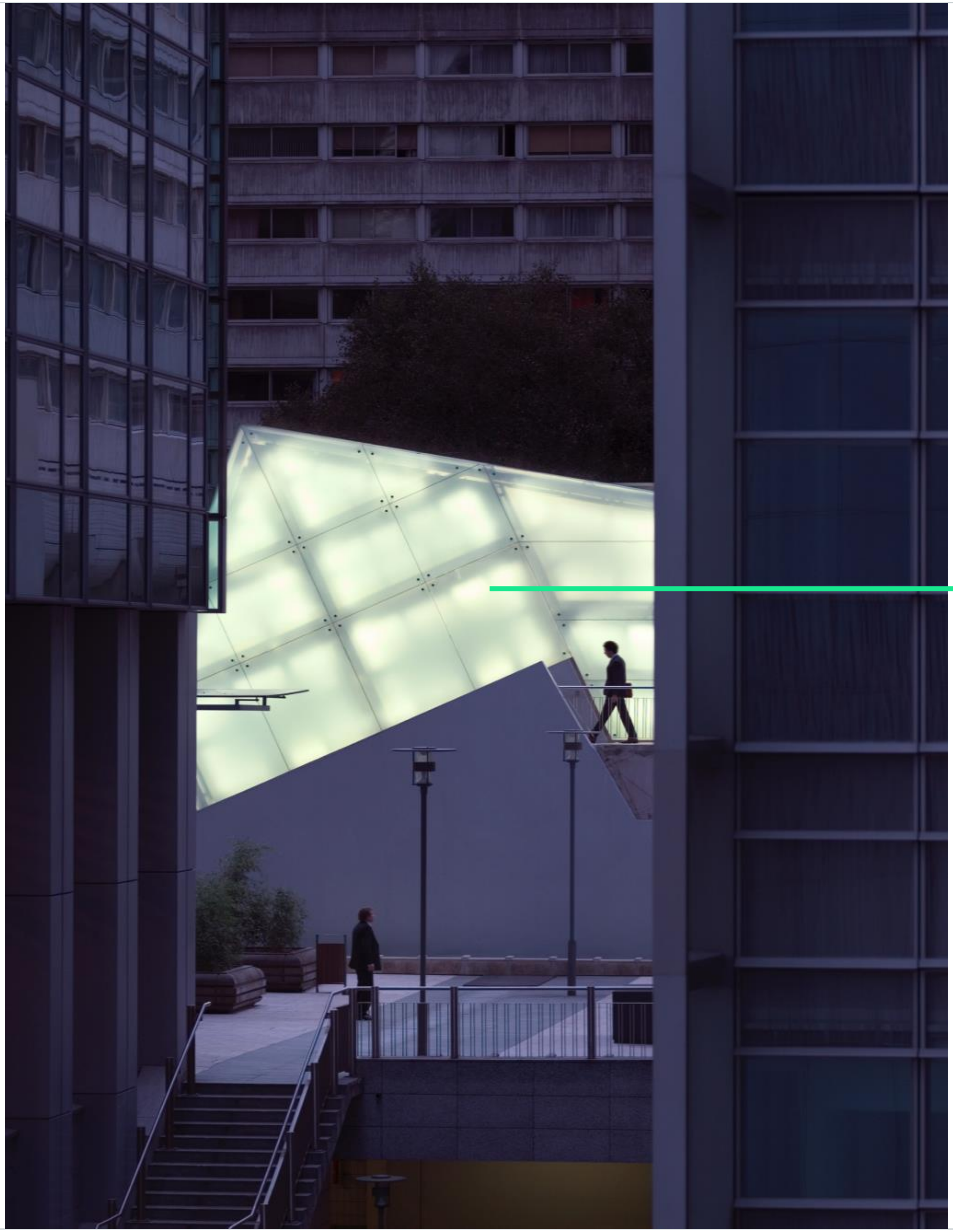
Baltic Outlook

While hurdles relating to the construction process continuously impact supply, the interest in Baltics' office space will continue intensifying. Strong demand is evident, and this is not only from local companies. Investment agencies report that the Baltics kept attracting foreign direct investment (FDI) projects in H1 2022. The FDI outlook is also positive for all Baltic States, given the countries' energetic independence, which is essential for a stable economy. Ambitious innovation plans also facilitate interest in the Baltics, e.g., the Lithuanian Government has raised an ambitious goal that Lithuania would step up at least 5 places in the WIPO Global Innovation Index.

By end-2022, the level of demand will remain exceptionally high for the prime space, making tenants execute quick decisions to secure the available space in the market. On the other hand, some tenants may fear recession signals and could be resistant to substantial changes.



Due to active projected deliveries, the total modern stock should reach the one million sqm mark for Tallinn and Vilnius by the end of 2022.

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04

Retail Market

What strategies might retailers deploy to tackle the expected decrease in consumer spending?

Highlights

01

MARKET OVERVIEW

Retail and service confidence has stayed above the EU average in the Baltics and remains positive, showing the consumer's ability to continue spending and retailers' positive prospects for the future.

02

RETAIL SALES GRASPING THE OPPORTUNITY

Retail sales seized the post-pandemic chance, and retail turnover increased in H1 2022, surpassing respective periods in 2019-2021.

03

MULTIFUNCTIONAL CENTRES

Shopping centres are experiencing a renaissance, turning from mono-functionality based retailing and remerging as multi-functional operations.

04

EUROPEAN TRENDS

BNPL, social retail, and omnichannel - consumer experience driven trends are emerging with shopping tailored to the quality and convenience needs of customers in all channels.

05

BALTIC OUTLOOK

Baltic consumers are becoming more cautious and socially aware, they are starting to review what they consume and reassessing their priorities.

Baltic SC KPIs

TALLINN / RIGA / VILNIUS

50 / 50 / 40

Prime Rent, €/sqm/mth

504 / 617 / 430

Total SC Stock, thous. sqm

0.0 / 7.0 / 0.0

Completions, thous. sqm

820 / 650 / 710

SC Density, sqm per 1K Inhabitants

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Market Overview

Retail and service confidence has stayed mostly above the EU average and remains positive in the Baltics, showing the consumer's ability to continue spending and retailers' positive prospects for the future. At the beginning of 2022, retail sales seized the post-pandemic opportunity, and retail turnover increased in comparison to H1 2021 also surpassing 2019 and 2020 levels for respective period. However, starting from June, the trade increase started to slow down and spending on non-essential goods has decreased. Such trend is set to continue.

Supply

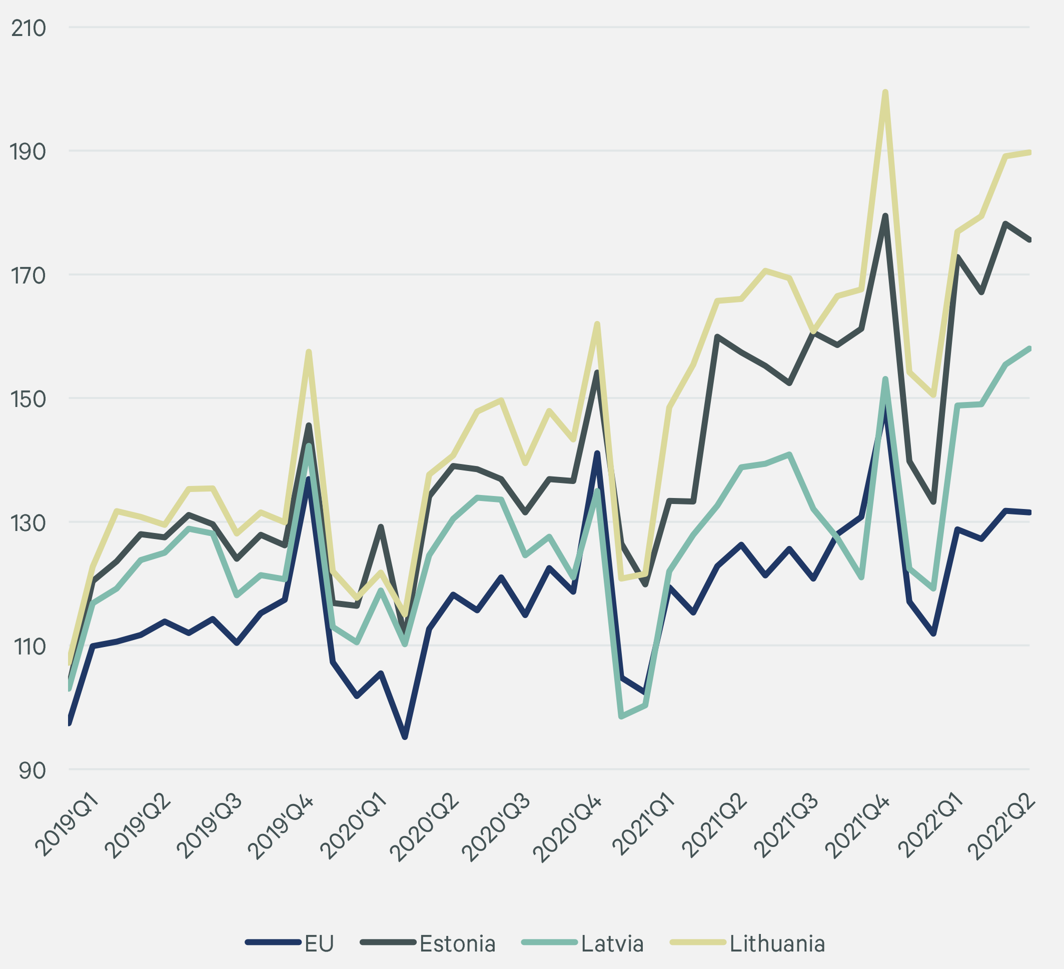
The retail market in the Baltics is already saturated, with shopping centre and modern retail density in the capital cities being one of the highest with over 600 sqm/per 1,000 inhabitants, while the average in CEE is just above 350 sqm/per 1,000 inhabitants. Accordingly, there have been no new shopping centre deliveries in H1 2022, except for the Domina SC in Riga, an expansion that has created the largest indoor entertainment centre in the Baltics.

The next two years will bring openings of multifunctional centres with more than 30,000 sqm dedicated to retail. In August Volta 1 started to operate in Tallinn and next year in Riga two multifunctional developments will be finished (Preses nama kvartāls, Novira Plaza). Further similar schemes are planned in the Baltic states. This indicates that after many years of mono-functionality based retailing, shopping centres are experiencing a renaissance, and remerging as multi-functional centres, supporting leisure and recreation, tourism, culture, housing, employment, health and education, combined with retail.

Leasing Terms

Rents continue recovering and are expected to be pushed a little further. Shopping centre vacancy, especially in secondary locations, has risen and will stay slightly inflated by the year-end. Looking at H2 2022, retailers will think about opportunities to limit energy and gas consumption. Some retailers plan to replace gas heating in stores with more sustainable alternatives. Shopping centres also plan to lower the temperatures of freezers and common areas.

Figure 5: Retail Trade, Except for Motor Vehicles, Motorcyles, and Fuel, Index=2015



Source: EUROSTAT, CBRE Baltics Research

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Retailers rated brick-and-mortar retail as more effective than online across all metrics CBRE asked about, but particularly for cross-selling products (61% agreed that brick-and-mortar was more effective) and consumer engagement (81%).

EMEA Retail Occupiers Survey 2022

European Trends

Social Retail

Social commerce is one of the biggest retail digital trends – and it's booming. The practice of using social media to engage customers is increasing to reach a younger target audience and sell across both physical and digital channels simultaneously. Nearly 83% of buyers in Europe use social media and online reviews to help them make purchasing decisions. In the Baltics, ca. 55% of enterprises are already using social media. A balanced influencer and consumer-generated content marketing strategy creates brand awareness, authenticity, and loyalty.

E-Commerce & Omnichannel Experience

E-commerce has been distributed unevenly in the Baltics (enterprises using internet sales account for ca. 19%, 15%, and 32% in Estonia, Latvia, and Lithuania, respectively, Europe's average – 19%). E-commerce penetration rates have eased during H1 2022 but are expected to continue growing in established markets. Less established markets will gradually catch up as urban population, digital skills, digital payments, and infrastructural access increase.

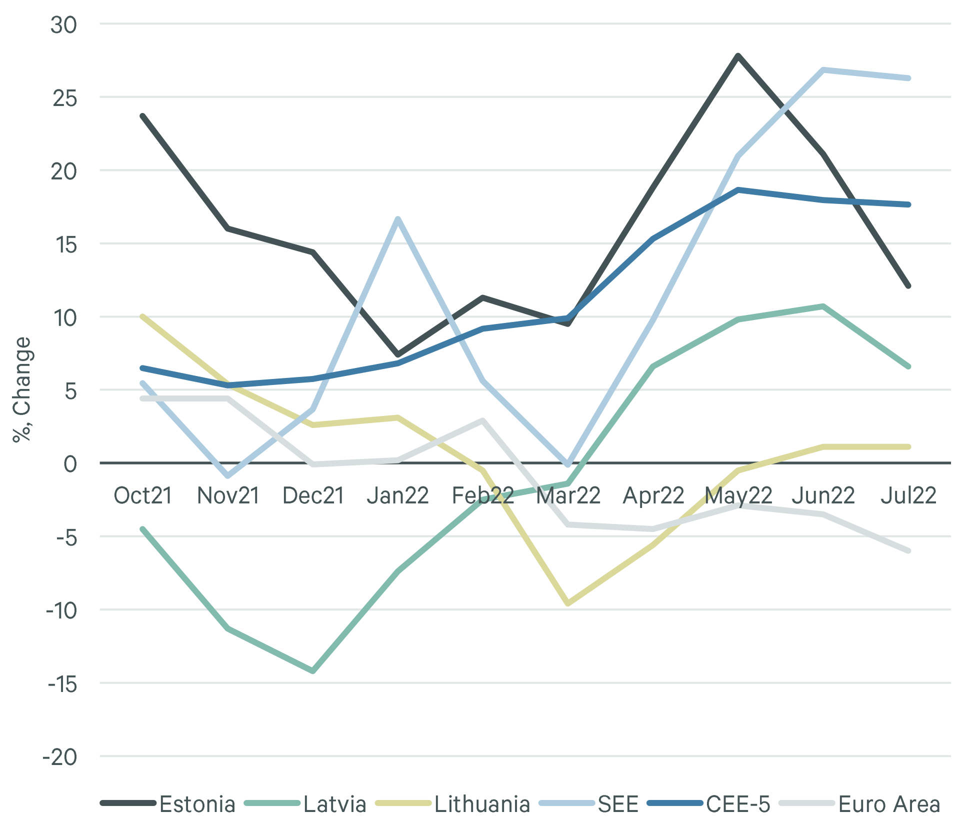
In omnichannel retail, the shopping experience blends with technologies and enterprises engage customers through multiple digital and physical touchpoints. Customers' data and available information moves with them as they move across channels. Customers expect connected journeys and, according to a Salesforce State of Connected Customers Survey, 83% of customers are more loyal to companies that provide consistency.

BNPL

After two years of the pandemic, consumers want to make up for the lost time, and By Now Pay Later (BNPL) providers are gaining more attraction in the market. People started using BNPL to upgrade their travelling experience, make bigger purchases. Also, it supplements smaller expenses for petrol, clothing, and home items.

The BNPL payment industry in Europe is expected to grow by 55% on an annual basis this year. BNPL is giving an opportunity for businesses to expand consumer base and distribute profits while also boosting the luxury segment. Simultaneously, it makes goods more accessible to customers, providing more flexibility.

Figure 6: Retail Confidence Indicator, Central Europe, Oct 2021-Jul 2022



Source: European Commission - (DG ECFIN), Eurostat, CBRE Research Own Calculation

Source: CBRE Research, European Commission, Telius International

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Baltic Outlook

Shopping Habits

Even after the restrictions were lifted, ca. 70% of people (aged 18-40) in the Baltics are still shopping online at least once a month. Preparing meals at home instead of visiting restaurants remained trendy, as well. People got used to surveying prices at home and going to discounters even if it meant a further distance to travel. There was ca. 30% annual increase in H1 2022 in second-hand store sales all over the Baltics. These trends indicate an appearance of a more socially aware shopper.

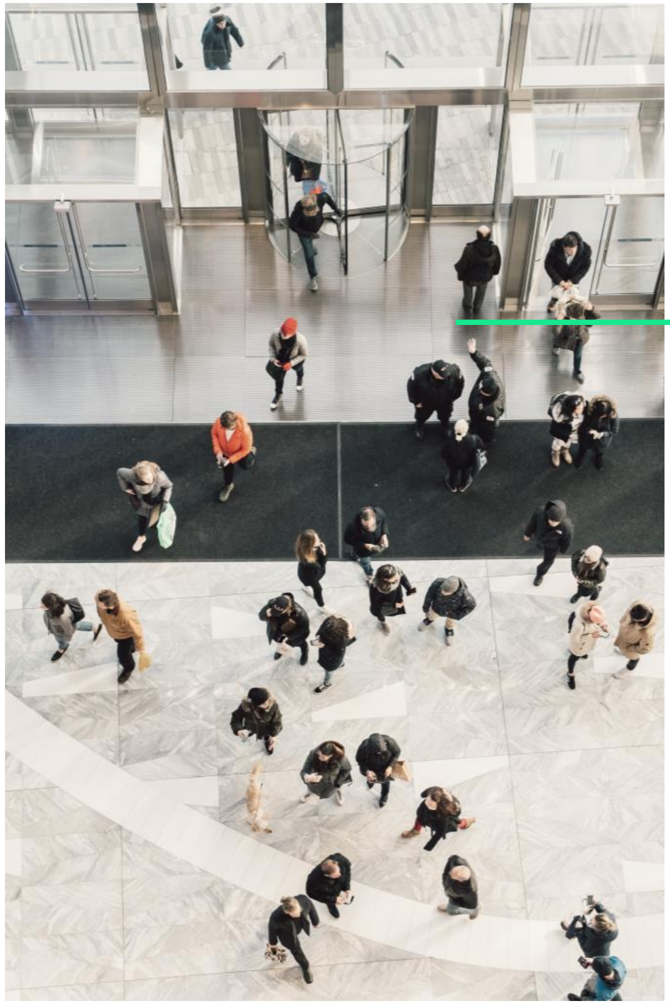
Regional Retail

Remote work possibilities have amplified over the last couple of years, and one in three Baltic residents is considering moving outside of the big cities. Such tendency has increased retailers' interest in the regions. Newcomer in Latvian market Spar is opening its first shops in regional cities. Pepco has also rapidly expanded across the regions, while Sinsay is setting up the plans to move outside of big cities.

Changing Concepts

Typical retail spaces are supplemented with innovative business models. Retailer demand needs are shifting to attract more customers. Dark stores and dark kitchen concepts are continuing to gain in popularity. Wolt Market and Bolt Market and independent dark kitchen concepts are expanding their operations in all three Baltic states. Pop-up concepts have proven to increase customer interest, as well. Brands such as Kenzo, H&M, Zara and many more are launching pop up stores and even pop-up restaurants.

Over the last couple of years, new multi-functional neighbourhoods were actively developed, which are designed to attract young professionals. Most buildings in these locations have first-floor tenants, with high levels of foot traffic. Therefore, many businesses are looking to rent premises in or around those areas.



In H2 2022, retail trade could drop as real wages and consumer confidence fall, while inflation soars. Such a trend was already evident in June when retail trade growth started to dampen.

With the expected increasing energy consumption in the cold season, retailers will think about opportunities to limit their spending on facilities.

Businesses should carefully prepare for such a situation in considering efficiency measures.

Source: CBRE Research, Luminor Bank Survey, Venipak Survey, Business Wire

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05

Industrial Market

To what extent might the global commodity supply shocks adjust the attraction of industrial assets in the Baltics?

Highlights

01

MARKET OVERVIEW

High demand and the lack of new projects are creating upward pressure on rents and lowering vacancies.

02

LABOUR SHORTAGES

The labour market has recovered from the pandemic but is now facing new issues due to the geopolitical tensions in the region.

03

SUPPLY CHAIN DISRUPTIONS

Supply chain disruptions are causing new projects to be delayed and material costs to go up, but upon the discovery of new options, the situation is expected to improve.

04

EUROPEAN TRENDS

High demand, low supply, rising rents and a low vacancy rate are the key marks for the European market at the moment.

05

BALTIC OUTLOOK

The geopolitical tensions have filled the markets with uncertainty. However, the demand for I&L properties is high and the outlook for H2 2022 is positive.

Baltic Industrial KPIs

TALLINN / RIGA / VILNIUS

4.6 / 4.6 / 5.0

Prime Rent, €/sqm/mnth

1.5 / 1.4 / 1.2

Total Stock, million sqm

50 / 68 / 16

Warehouse Space of Total Stock, %

63 / 46 / 73

Modern I&L Properties, Built <10 Years Ago, %

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Market Overview

Supply

In H1 2022, the pressure on the industrial market activity has continued. The biggest hurdle for the modern industrial stock growth is still the ongoing supply chain disruptions.

In Vilnius, in Q2 2022 the first stage of J55 logistics center was completed, adding over 20,000 sqm to the market. In Riga, the 8,800 sqm MDL warehouse in the Airport area was introduced to the market. In Tallinn, no new big completions were brought to the market in H1 2022. However, a total area of around 150,000 sqm is currently under construction in Harju region (incl. Tallinn) alone. Overall, around 300,000 sqm of new I&L projects are under construction throughout the Baltics.

Demand

With the popularity of e-commerce still growing fast, the modern warehouse space is quickly absorbed in the market, with the demand for stock offices continuing to remain high. As the demand is increasing and supply is falling behind, it is expected that the developments of modern speculative stock should intensify in the Baltics.

However, the lag in supply depends on the ongoing disruptions in the supply chain. Under the current circumstances, commissioning a new built-to-suit warehouse takes up to 18-24 months, usually observed as an extended period. Thus, many tenants look to older B-class premises or start negotiating their current leases, although at increased rent rates.

Market Rents

Due to increasing demand for modern industrial premises, high inflation, and supply chain disturbances, prime rents are expected to rise. In some cases, it is already evident by pushing the smaller unit rents to 6.00 EUR/sqm/month, in contrast to an average rent for industrial and logistics of 4.5 EUR/sqm/month. The prime rent in the Baltics stands in the region of 5.15 EUR/sqm/month.

Vacancies

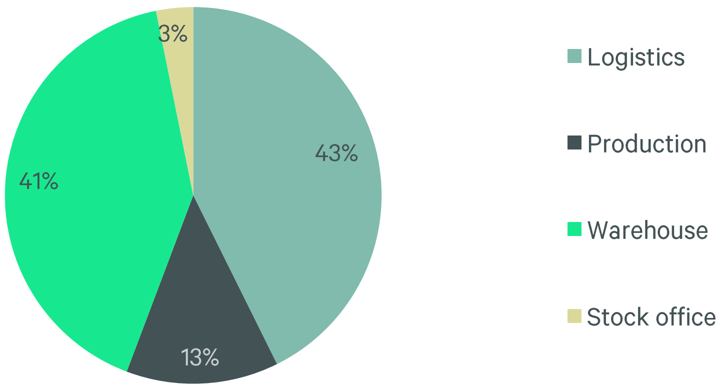
Increasing demand and lack of supply of new speculative developments have decreased vacancy rates in the region, which currently stand under 2%. However, given the current market conditions, vacancies are expected to drop further in the upcoming half year.

Figure 7: Selective Sizeable Pipeline Developments for H2 2022

Project name	Country	City	Type of development	Developer	GLA, sqm
JYSK Logistics Centre	Latvia	Riga	Distribution & Logistics	VGP	42,000
Rumbula Logistics II Phase	Latvia	Riga	Distribution & Logistics	Sirin Development	32,500
J55 II Phase	Lithuania	Vilnius	Distribution & Logistics	Sirin Development	32,000
Iru Ärikeskus	Estonia	Tallinn	Stock offices	Favorte	9,500
FlexStart 02	Lithuania	Klaipeda	Distribution & Logistics	Klaipedos Verslo Parkas	8,500

Source: CBRE Baltics Research

Figure 8: Type of Modern Industrial Stock, Baltics



Source: CBRE Baltics Research

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Under the current circumstances, commissioning a new built-to-suit warehouse takes up to 18-24 months, usually observed as an extended period. Thus, many tenants look at older B-class premises/brownfields or start negotiating their current leases, although at increased rent rates.

In the short term, it is expected that material shortages, the fragile global supply chain, together with high energy and equipment prices will weigh on production and logistics capacity.

Labour Shortages

After the pandemic, the labour market recovered relatively quickly. Within a year, the Baltics has arrived at a situation where the labour market is almost at the pre-crisis level.

With the demand for e-commerce rising, so is the industrial sector's labour demand. In the future, automatization is expected to be employed at a high pace, but for now, tenants have intensive use of physical labour. The labour supply in the Baltics has also recently been supplemented by the Ukrainian arrivals to the region.

While the employment rate is steadily rising, wages remain the heavily discussed question. As the employment rate dropped at the beginning of 2020, wages have been growing ever since. This is a major consideration for employers in the industrial sector who sometimes struggle to employ the right fit given high salary expectations. Moreover, given the finite number of local experts in the field in the Baltic region, the industrial market faces a significant positive skew in salaries' distribution.

Companies in the I&L sector have already started the automatization process. Thus, the labour shortage problem is expected to become a less significant problem in the upcoming decade.

Supply Chain Disruptions

Many new construction projects are delayed due to material shortages and cost inflation. One of the main reasons behind this is the geopolitical tension in the region. Most of the material used at the construction sites used to come from Ukraine and Russia. With the embargos imposed on the latter, developers and construction companies struggle to replace the suppliers and tend to acquire raw materials at the unprecedently high costs.

With the broken supply ties, materials are ordered from more remote partners. Thus, the rise in costs has become inevitable. This has significantly contributed to the vast increase of inflation, which developers find hard to battle. Unfortunately, this is not the only issue. The skyrocketing global shipping costs are also causing a shortage of goods and materials. As a result, it will put substantial upward pressure on construction prices and rents.

In the short term, it is expected that material shortages, the fragile global supply chain, and high energy and equipment prices will weigh on production and logistics capacity. However, the markets tend to balance themselves out. Thus, reconfigurations of the supply chains will impose a new normal in the market.

15%

Construction price index rise in the Baltics, H1 2021 vs H1 2022

Source: Eurostat, 2022

100k+

Ukranian refugees have applied for temporary protection in the Baltic countries

Source: ERR, 2022

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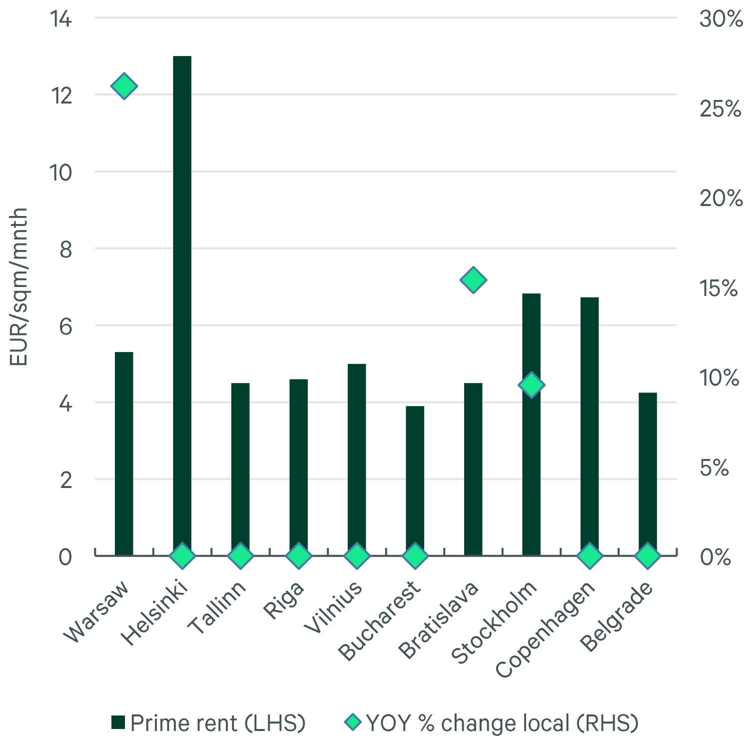
European Trends

- Due to high demand, vacancies are dropping and rent prices are growing. E.g., in Finland, the overall vacancy has fallen below 4%, while the vacancy for properties >10,000 sqm has dropped to under 1%. In Poland, the situation is even more difficult. The vacancy rate for the country is 3%, but in cities like Poznan or Krakow, there is no space available immediately.
- Vacancies are not low due to the shortage of new supply. E.g., in Poland, in Q1 2022 alone, 131 mln sqm was delivered, the highest quarterly result in history. Another 4.5 mln sqm is being constructed (twice as much as in the same period last year).
- With high demand, the rent prices for prime I&L properties are rising. Although in some CEE and Nordics countries there has not been a drastic rise in rents, the vacancy rates are dropping, creating upward pressure on rents.

Figure 9: Warehouse Prime Rents and Change in Europe, H1 2022 vs H1 2021



Source: CBRE Research, CBRE Baltics Research

Baltic Outlook

- The continuing supply chain disruptions and construction cost increases have not halted the market. Yet, the growing popularity of e-commerce is expected to increase the demand for new warehouses.
- Insufficient supply of new warehouses may create a problem where there is not enough space for tenants. This has already imposed upward pressure on rents. Such a trend will only deepen. It may create an opportunity for B-class owners to renegotiate higher rent prices.
- The vacancy rate will continue to drop, and the trend will go on for the near future.
- The situation could ease when new shipping routes are opened, and the supply chain disruptions and material shortage issues are resolved.

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06

Residential Rental Market

How will the Baltic market greet the new adventurists ready to invest in the rental residential sector?

Highlights

01

MARKET OVERVIEW

The lack of quality existing supply brings pressure on the rental sector. As a result, rent rates have increased by at least 15% since the beginning of 2022.

02

STUDENT HOUSING

It is expected that the 2022/23 academic year will attract more international students to the Baltics. However, despite the growing demand, there is a lack of available student housing projects.

03

HOUSING OPEX

The balance between affordability, sustainability, and security is considered by landlords with continuously growing energy prices in the market.

04

EUROPEAN TRENDS

Across Europe, there is a strong demand for rental residential with an increasing focus on affordability. Lack of products may push investors into forward-funding projects, mergers, and acquisitions.

05

BALTIC OUTLOOK

Although the market desperately needs professionally managed residential rental schemes, there is a lack of financing and know-how in rental scheme operations in the Baltics.

Baltic Private Rental Sector KPIs

TALLINN / RIGA / VILNIUS

20 / 18.5 / 21

Prime Rent, €/sqm/mth

1100+ / 2100+ / 900+

Total Stock, Apartments

250+/ 1300+ / 2800+

Pipeline, Apartments

26 / 74 / 11

Multi-Family Rental of Total Stock (incl., student housing & co-living), %

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Market Overview

Displaying low overall vacancy, a record high capital values, and durability through the pandemic, the multifamily rental sector assets have become a preferred product among the other core sectors for both institutional and retail investors in the Baltics. However, the lack of supply will not be resolved anytime soon, as elevated construction costs, barriers for developers to obtain construction permits, and increasing interest rates make it difficult to finance such projects.

The housing market gained momentum in all three Baltic capitals, reaching record levels of transaction volumes, steep price increases, and strong demand during H1 2022. However, due to the anticipated economic downturn, growing interest rates will lead to weaker buyer sentiment and an overall retail market slowdown.

When markets are slowing down, it is expected that continuous growth of demand for multifamily rental sector products will be witnessed, putting further pressure on rent rates, that in some cases have increased by 20-30% annually. However, a further rent rate increase is dubious during the late autumn and winter months since the utility cost increase will be apparent, and the real salary increase is less evident.

In the past three years, construction costs have seen multiple upward rallies. At the end of H1 2022 the YoY Baltic construction prices increase was between 20-25% depending on location, explaining steep apartment price and rent rate increases for primary market apartments. It is evident that construction costs will continue to increase.

Although the market desperately needs professionally managed rental schemes, the lack of product will continue to drive the market, where most participants are non-professionals or private individuals.

Figure 10: Number of Rental Residential Apartments, Baltics, H1 2022

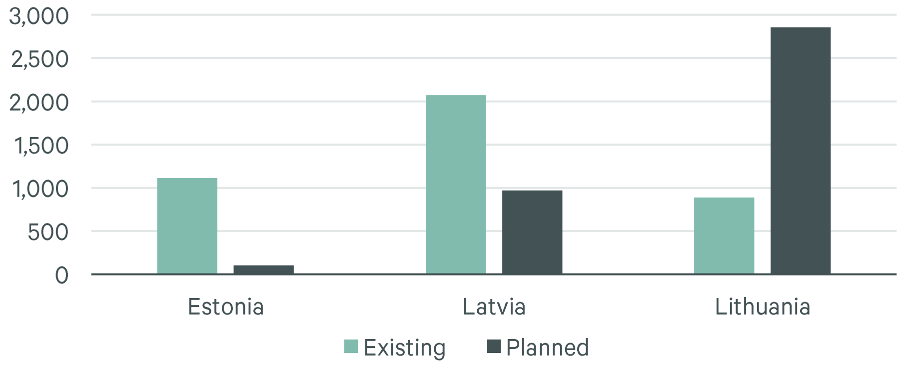
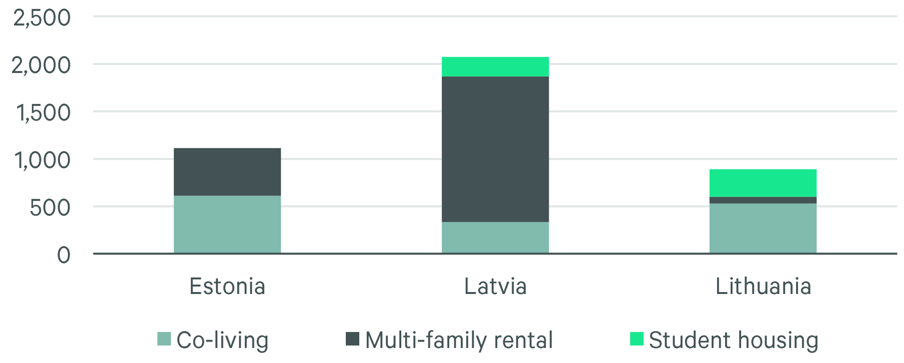


Figure 11: Existing Co-Living, Multi-Family Rental, and Student Housing Stock, Baltics, H1 2022



Source: CBRE Baltics Research

Note: *Student Housing* stock includes projects operated by private entities (stock operated by universities is excluded)

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> Although the market desperately needs professionally managed rental schemes, the lack of product will continue to drive the market, where most participants are non-professionals or private individuals.

Mārtiņš Grīnbergs
Senior Analyst, Research & Consultancy

Student Housing

During the pandemic years not only remote work affected the office sector, but remote studies also increased overall vacancy in dormitories and student housing properties across the Baltics.

Assets that involve international students, e.g., co-living projects, saw the steep decline in demand. Many students left the Baltics right before the lockdowns and returned only during H1 2022, when most of the pandemic restrictions were lifted and on-site studies were resumed.

In terms of modern student housing, the Baltics still lag behind the rest of Europe. Most of the student housing stock is owned by universities and sometimes is obsolete.

Nevertheless, the past few years have witnessed modern student housing project planning and development, especially in Lithuania, where more than 700 apartments for students are available in the market. Riga instead has a strong pipeline, with 240 apartments announced to be commissioned at the end of 2022 and more than 300 apartments in the planning stage.

Housing OpEx

When an energy price related topic is seen in every other news headline, the balance between affordability, sustainability, and security has landed in every landlord's mind. While four years ago, a fixed single payment for a studio apartment in a rental building was a rule of thumb, now landlords are being forced to review their agreements in order to maintain positive cashflows during the upcoming cold season, by asking their tenants to pay, not as a year ago an agreed single payment, but prices aligned to the market.

Baltic Outlook

Despite the harsh economic signals, the rental residential market has a strong overall outlook. Until the end of the year we might not see a further rent rate increase, as a further rise may affect affordability and demand. However, there are around 3,000 different types of rental residential apartments under construction, that will be delivered until the end of 2023, and about the same amount of apartments in different planning stages, across the Baltics.

European Trends

The residential sector showed resilience against the Covid-19 crisis and continues to show strong results during the overall economic downturn and high inflation across the Europe. Multifamily is still one of the most active segments in 2022, that is assured by high tenant activity and low vacancy rates in the market.

A trend which is about to be set in the Baltic region as well, is forward purchasing. All across the Europe, due to limited availability of existing multifamily housing projects, the number of forward purchases has gained momentum.

Due to increased construction material prices, and overall inflation, people tend to look for cost saving opportunities. One of the ways now considered by Europeans is secondary cities; while rents outside capital cities usually are lower, yields on the other hand are higher, making this sector an interesting long-term investment opportunity.

>2%

Average vacancy in rental residential projects usually is below 2%

6000+

Apartments under construction or in planning across the Baltics

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