# Lithuanian Commercial Real Estate Q2 2016

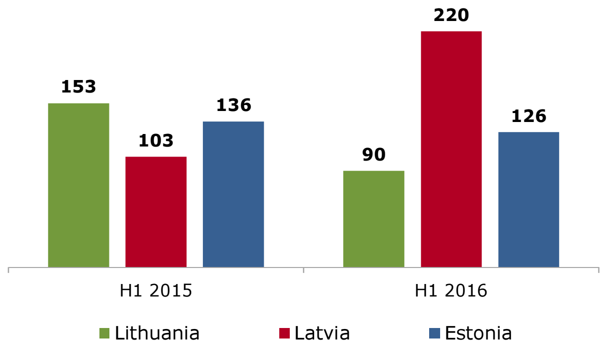
# MARKET COMMENTARY

Investor appetite for commercial property in the Baltic states continues to grow rapidly. The first half of 2016 was particularly successful for both the buyers and sellers of modern commercial property. A total of 22 investment transactions were concluded during this period in **Lithuania, Latvia and Estonia**, as a result of which 423,000 sqm of modern commercial property (offices, retail, warehousing and industrial buildings and premises) was purchased. The total value of the acquired properties amounted to **EUR 436 million**, which was **11% more** than during the first half of 2015.

Latvia, which was for a long time lagging behind Estonia and Lithuania, is in the lead this year. The total investment in commercial real estate in Latvia over the period reached EUR 220 million or almost 51% of all investment in the Baltic states. In the main this is due to two large investment transactions in Riga involving acquisition of the shopping centres Domina and Riga Plaza totalling EUR 168 million. In Estonia, investment transactions amounted to EUR 126 million or almost 29% of all investment in the Baltic states. The largest investment transactions in Estonia were recorded in the retail premises sector involving the purchase of two shopping centres Mustamae Keskus and Magistral in Tallinn. With the total value of acquisitions amounting to EUR 90 million, investment amounts in Lithuania during the first half of this year were the smallest. The largest single transaction in Lithuania was the acquisition of the remaining part of the shares from the developer of Nordika shopping centre in mid-2016. At the end of 2015, the Estonian company Zenith Capital Management already acquired half of the shares of management company of Nordika. One of the most interesting transactions in the Baltic states was reported in March 2016 where Laurus, a joint venture of Partners Group and Northern Horizon Capital, acquired 40 different commercial units across the Baltic countries (mainly current or former units of SEB bank) from the Dutch company Geneba. In 2014, Geneba took over the major portion of the real estate portfolio in the Baltic states managed since 2007 by Homburg Invest.

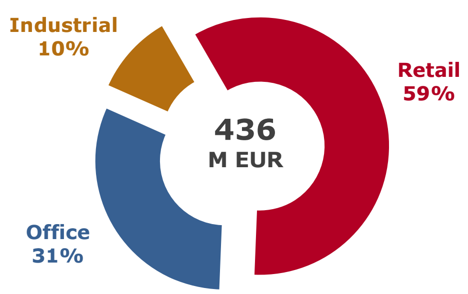
The scope of investment in the Baltic states per real estate segments shows that retail property has been most popular this year. Out of EUR 436 million invested in Lithuania, Latvia and Estonia, 59% was investment into the retail property sector. Investment in offices accounted for 31% of total investment and investment in warehousing and industrial traditionally accounted for the smallest (10%) portion of total investment. The largest transaction in the latter sector was reported in June where the Estonian EfTEN Real Estate Fund III acquired three logistics centres in Vilnius, Riga and Tallinn from DSV, the international transport and logistics services group.

**Investment volumes in the Baltics**
(modern commercial property, million EUR)



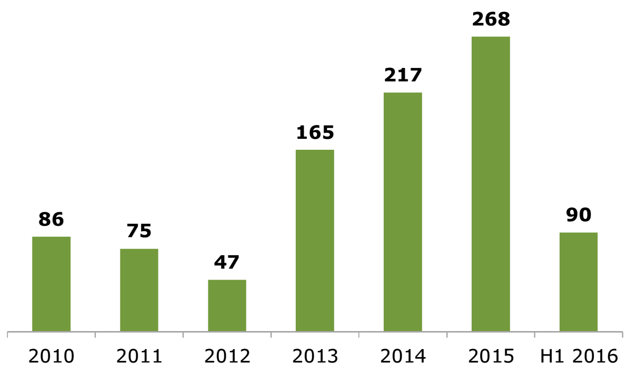

Source: Ober-Haus  Data: H1 2015 – H1 2016

**Investment distribution by real estate sectors in the Baltics**




Source: Ober-Haus  Data: H1 2016

**Investment volumes**
(modern commercial property in Lithuania, million EUR)




Source: Ober-Haus  Data: 2010 – H1 2016

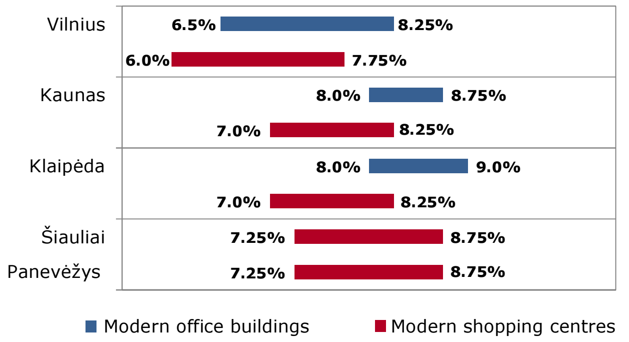
Evaluation of investment in this year and previous years shows that the commercial real estate in the Baltic states continues to be of interest only to local and Scandinavian capital investors. Investors from other regions are mostly companies, which are not directly related to real estate, or larger investment funds, which acquire large international real estate portfolios and as a result sometimes take over properties in the Baltic states (e.g. in 2015, the fund of the US asset management company Blackstone acquired a high value real estate portfolio in Scandinavian countries, including three shopping centres in Riga). Despite individual larger investors arriving directly to the markets of the Baltic states, statistics has for a long time shown a steady trend. Over the first half of 2016, it was mostly funds of the Baltic states and private investors who invested in modern commercial real estate (47% of total investment). Scandinavian capital investors accounted for 19% of total investment and investors from other countries (Switzerland, Russia, Malta and etc.) accounted for the remaining 34% of total investment.

It is likely that the second half of the year will remain sufficiently active in the investment transaction market. Despite growing expectations of property owners concerning the value of the property, buyers continue to be actively interested in and negotiate acquisition of different types of commercial property. The pending transactions, which, it seems, will be completed by the end of this year, are likely to yield most positive annual results in the Baltic states.

Smaller volumes of construction in the country, but growing numbers of transactions was the trend observed in Q1 and Q2 2016 in the Lithuanian commercial real estate market. According to Statistics Lithuania, in the first half of 2016, the value of construction works carried out in the non-residential building segment **in the country** was nearly **EUR 348 million** or **15% less** than during the same period in 2015. According to the State Enterprise Centre of Registers, during the first six months of the year, there were 25% more non-residential property (buildings and premises) purchase and sale transactions concluded in Lithuania compared to the same period a year ago.

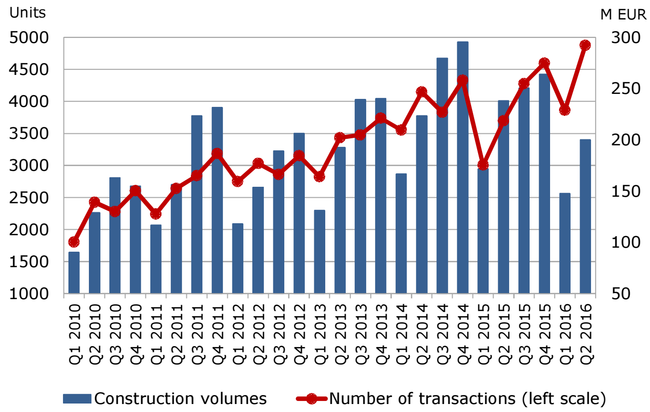
The most important news in the commercial real estate market in Q2 2016 was launching of the operations of the German supermarket chain Lidl in Lithuania. In early June, this low-priced product retail chain opened 15 stores followed by another four in July and August. Lidl will continue expansion of its new standard size stores in various cities across the country. The German chain is ready to compete with other market players not only by its operations in the strategic locations of the cities, but also by its investment in environmentally friendly solutions.

**Commercial property yields**



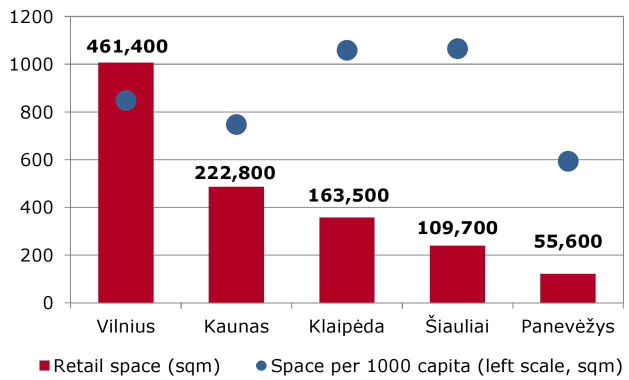

Source: Ober-Haus Data: Q2 2016

**The volume of construction of non-residential buildings and number of transactions in Lithuania**




Source: Statistics Lithuania, SE Centre of Registers Data: Q1 2010 – Q2 2016

**Shopping centre stock**
**(over 5,000 sqm GLA and over 10 tenants)**



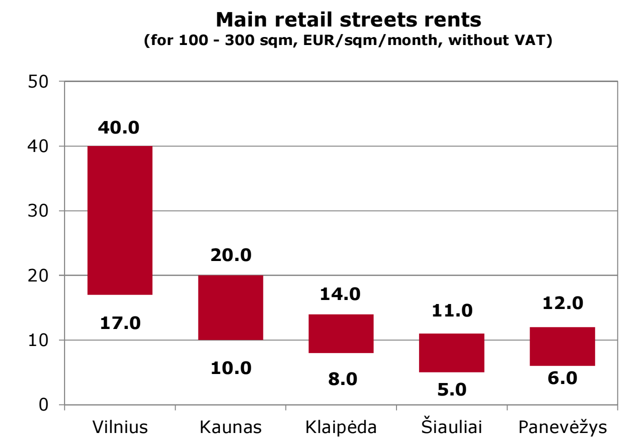

Source: Ober-Haus Data: Q2 2016

According to Lidl, all its buildings in Lithuania comply with top evaluation according to BREEAM In-Use – the international certification system of buildings for sustainability. So the Lidl seeks to attract the broadest range of buyers not only with its low prices of goods, but also by introducing a modern shopping spot in its new concept stores.

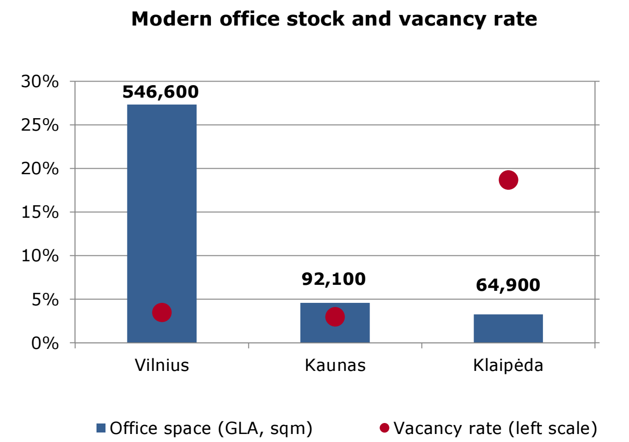
In recent years, no active development of larger traditional shopping centres has been noted in Lithuania, but in May this year, after a longer break the capital city saw the opening of a large shopping centre. This was the second and final stage in the development of Nordika shopping centre located in the southern part of Vilnius. With over 35,000 sqm of retail area and over 50 tenants the shopping centre is the fourth largest shopping centre in Vilnius (in terms of GLA). The last time shopping centres larger than Nordika were opened in Lithuania was in 2009 (Akropolis in Šiauliai and Ozas in Vilnius). In mid-2016 the total lettable area in the shopping centres in **Vilnius** was **461,400 sqm** (849 sqm/1,000 inhabitants of Vilnius).

On the basis of publicly available plans of developers, development of larger shopping centres in the nearest future will be limited only to Vilnius and Kaunas. Next year, developers of Nordika plan to start development of retail and office premises in the adjacent land plot of 9 hectares near Vilnius Airport and invest about EUR 55 million over the next four years. Construction of a large shopping centre is also planned in Drujos Street in Vilnius (former site of Audėjas textile company) and the works of renewal and expansion of Mega shopping centre (with reopening scheduled at the end of this year) continue in Kaunas. Development of larger traditional shopping centres in other regions of the country is hardly likely - it seems that investment will continue to be made only in smaller new stores and renewal or development of already existing shopping centres.

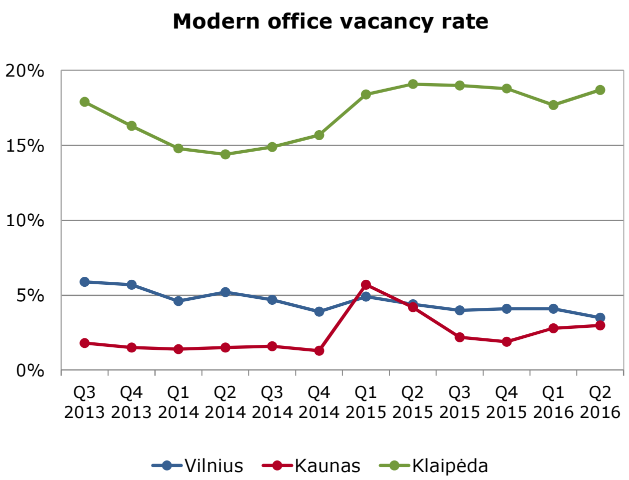
In Q2 2016, increase in office supply has been recorded even in Klaipėda – construction of M19 business centre with total area of 2,000 sqm on Minijos Street was completed. This is the second office building by Stemma Management offered to the office market in Klaipėda over the past few years (at the end of 2014, this developer completed a small project, Liepų Offices, in the centre of Klaipėda). Following the completion of the project, the total usable office area of modern offices **in Klaipėda** increased to **64,900 sqm**. Despite the tenants' interest in new office projects (e.g. most of M19 business centre has already been let), previously built business centres are not particularly attractive and the total vacancy rate remains very high. At the end of Q2 2016, the vacancy rate of modern office space was **18.7%**, whereas office rents remained same as at the end of Q1 2016 – B class office rents ranged from **6.0 to 9.0 EUR/sqm** and A class – **8.5–12.5 EUR/sqm**.




Source: Ober-Haus Data: Q2 2016




Source: Ober-Haus Data: Q2 2016




Source: Ober-Haus Data: Q3 2013 – Q2 2016

At the same time the office market in Kaunas is gaining momentum. So far, investors in Kaunas have focused on the development of small administrative buildings and have been slowly getting ready for larger projects. At the beginning of 2016, reconstruction of one administrative building (Neris Business Centre) was completed, but completion of the construction of another five projects (on Vytauto Avenue, Taikos Avenue, Pramonės Avenue, Partizanų Street and Savanorių Avenue) is scheduled in the second half of the year and will offer modern office premises to tenants. In total, the office market in Kaunas will gain 11,300 sqm of office space in 2016. In mid-2016, the total usable office area of modern offices **in Kaunas** was **91,300 sqm**.

An even greater leap in the supply of office premises in Kaunas is planned for the period 2017–2018, when considerably larger business centres will be offered to the market. To sum up the intent of developers, during the next few years at least 6-7 new projects currently at various stages of completion (from already started construction/ reconstruction to approval/design stage) could be implemented in Kaunas. These are projects, which are already being developed and planned on Jonavos Street, Vytauto Avenue, Karaliaus Mindaugo Avenue, K. Donelaičio Steet, K. Baršausko Street and Savanorių Avenue, could offer to the market in total up to 30,000 sqm of modern offices. This would be a really great impetus to the development of the offices market in Kaunas, since at the moment potential larger tenants have almost no choice. The vacancy rate of modern offices in Kaunas in mid-2016 was only **2.1%** or 2,000 sqm. Changes in office rents are also conducive to the development of new projects. Although the increase in rents is not significant (during the first half of the year rents for office space in Kaunas increased on average by **5%**), this is an extra incentive to developers. Currently B class office premises are renting for **6.0-10.0 EUR/sqm** and A class – for **10.5-13.0 EUR/sqm** in Kaunas.

The second half of this year promise abundant developments in the office market in Vilnius. All six projects in progress (Quadrum, CITY, 135, Green Hall 2, HIGHWAY and Delta) will be completed offering **82,600 sqm** of office space. Since no new business centres were opened in the first half of the year, the vacancy rate in **Vilnius** business centres decreased to **3.5%** totalling **19,000 sqm** at the end of Q2. Developers declare they will offer another **69,200 sqm** of modern office space across 13 different projects (on V. Gerulaičio Street, Saltoniškių Street, T. Narbuto Street, Lvovo Street, Naugarduko Street, P. Baublio Street, Liepyno Street, Mozūriškių Street, Verkių Street, Viršuliškių Lane, and Kareivių Street) in Vilnius in 2017. Since the great majority of these projects are actually in the construction phase, it is likely that they will be implemented and in 2016–2017 we will have the same impressive volumes of development of office space as it was in 2008–2009.

Particularly rapid development of offices eight years ago coincided with the start of the global financial crisis and resulted in the leap of the vacancy rate to 10% at the end of 2008. At the end of 2009, the vacancy rate was almost 18% and rents in 2009 dropped by 40%. Repetition of such scenario in the present economic and market conditions is unlikely. Sustainable economic growth of the country and increasing attractiveness of the capital city to investors (arrival and expansion of international companies) has up to now determined a sufficiently smooth realisation of new office building projects and allows to expect that on the day of opening of newly built business centres, the vast majority of premises will also be let. It should also be noted that some part of the buildings and its premises is developed for own use and builders or companies related to them will move from old premises to newly built ones. Therefore a leap in the vacancy rate is not expected this year, however, starting from the second half of 2016, a moderate increase in the vacancy rate will be observed.

Competition between business centres in Vilnius has been sufficiently strong recently and this is attested by stable rents, which have not essentially changed since the end of 2015. Currently B class office premises are renting for **8.5–13.0 EUR/sqm** and A class – for **13.5–16.5 EUR/sqm**. Compared to the lowest rents in 2010, rents for office space in Vilnius have on average increased by over 40%. It can be said that the current and planned supply and demand ratio has determined the office rental market peak and it is unlikely that during the next few years rents could considerably increase.



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