



Commercial Market Report

1st Half 2008

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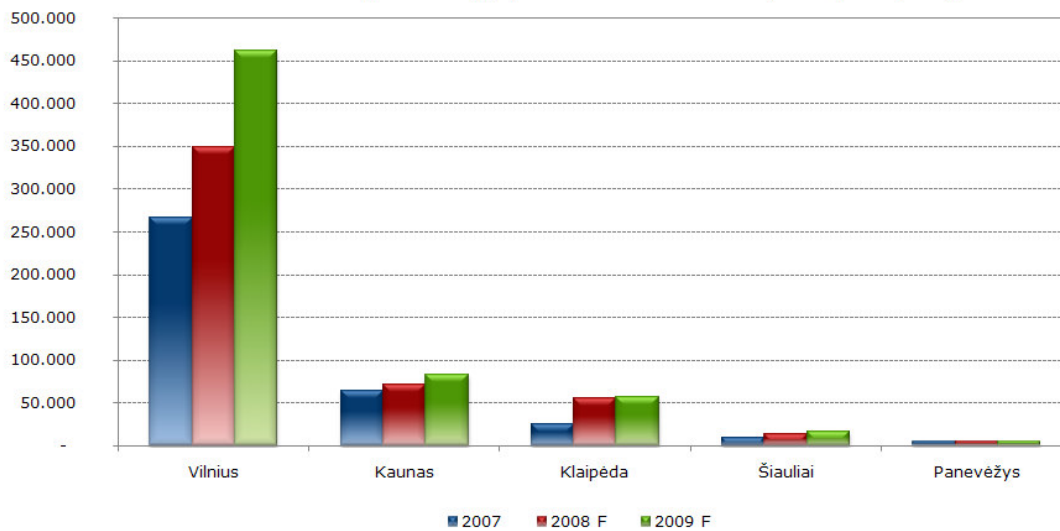
The higher cost of borrowing and the slowdown of Lithuanian economy also affected the business premises sector. Decreasing interest from potential buyers and lessees for objects offered by the market was felt both in the lease and sales segments, however, compared to the residential sector, prices remained stable. Generally, the sector of commercial premises is considered to be more stable than the residential sector. Emotions, rumours and unjustified expectations have less influence over demand in the commercial sector; therefore, changes in price are more reasoned and reflect the results of the country's economy. It is not surprising that in a period of slowing development of the country's economy, many buyers and lessees have become more careful and assess their future perspectives more conservatively than before. However, developers, whose projects have already reached the final stage of implementation, do not have to worry too much at the moment—the majority of nearly finished or already finished objects demonstrate striking results for occupation. The occupation of functioning modern buildings and complexes in all the main segments of commercial real estate (the markets for warehouses, retail and office premises) of Vilnius, Kaunas and Klaipėda ranges from 95 to 99 %. Similar occupation indicators are expected until the end of this year.

The future of projects scheduled for subsequent years up until 2009 is more obscure because the developers will have to cope with much higher competition than before. A lack of business premises in the period of intensive development of the Lithuanian economy opened up an opportunity for builders to construct premises in less attractive areas, and developers of less functional projects to successfully find buyers and lessees for their premises. The growing supply of modern business premises will create conditions in which the owners of older, less modern or morally outdated premises will have increasingly smaller opportunities to compete with the newest buildings, unless they can offer lower lease or purchase prices than the developers of new objects. This is a matter of great relevance to the owners of offices and shopping centres.

Office

A review of information about new projects for office premises scheduled for the years 2009–2012 shows that the market will be threatened by an apparent surplus. At the end of 2008, the total rented area of all modern offices in the capital will amount to nearly 350,000 m². Meanwhile, plans have now been announced in Vilnius to implement around 40 new A and B class projects for the subsequent four years, with a total rented area of over 300,000 m². Thus, the supply should be almost double in 2012. However, an extremely strict funding policy by banks will probably result in a maximum of 30–40 % of the best projects being carried out. It is becoming increasingly obvious that Lithuanian commercial banks, having established especially high requirements for builders, will enforce a certain quality barrier and will not allow projects of dubious quality and functionality to saturate the market. On the other hand, it is very likely that banks, while trying to protect themselves and the market from oversupply, may go over the top and cause a lack of office premises in the market which will be felt for several years.

Modern office space supply at the end of the year (GLA, m²)



When analyzing the tendencies of rents, we come to the conclusion that growth of the Lithuanian economy and very good results of many companies over the past several years were the main reasons for rapid growth of local companies. This growth led to an increase in demand for modern office premises and a rapid growth in rents. The rents of offices in Lithuanian cities increased by at least 5–15 % in 2006 and 2007, however, there was no increase in prices in the first half of 2008 and rents remained stable. The slowdown of growth in the country's economy also influences the gradually decreasing interest in office premises and the decreasing optimism of potential lessees. Today, companies evaluate their growth opportunities more carefully and choose office premises very attentively. They pay attention not only to the rents but also to the prices of common premises, parking lots or additional services. Therefore, it can be expected that companies will try to reduce expenses for the maintenance of premises as much as possible if the growth in the country's economy slackens further. Companies will probably decide to move to cheaper premises or to bargain more actively with the owners of current premises after the expiry of their lease agreements. This may lead to either a reduction of rents for modern premises, or changes in the occupation indicators of office premises. At present, the occupation of office premises in functioning business centres in Vilnius is at a record level of 98–99 %. New office buildings will continue to be opened in Vilnius until the end of 2008, and this indicator may decrease to 95–97 %. When an extra area of 110,000 m² becomes available in the market at the end of 2009, this indicator may even further decrease to 92–94 %, i.e. the same level as in the years 2003–2004. At that time a record number of modern office premises were offered to the market, but the market could not absorb them.

Modern office occupancy in Vilnius



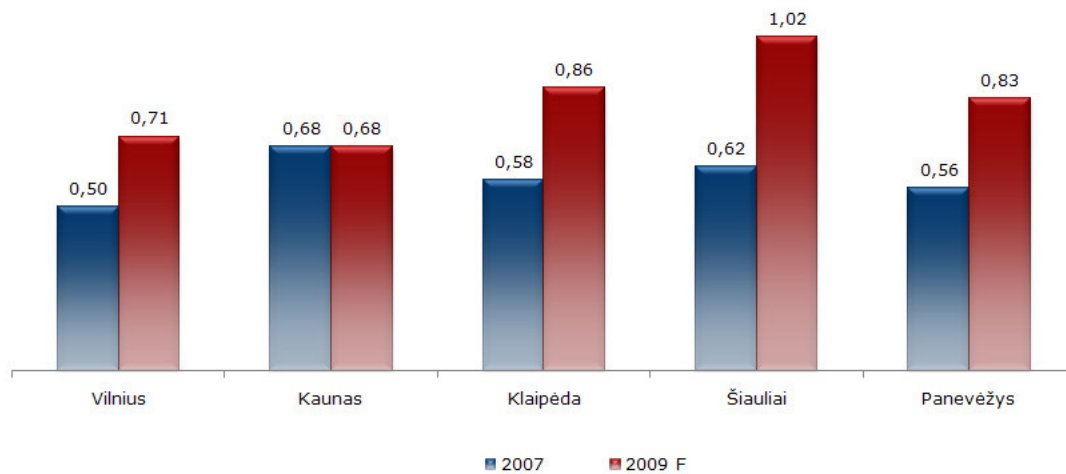
It should be noted that the majority of the supply of modern offices intended for lease will be office premises of class "B". Companies that require offices in the business centre of class "A" located in the central part of the city in the mentioned period, will only be able to choose from one project. At present, only the business centre "Vilniaus verslo uostas" near Konstitucijos Avenue, with an area of 30,000 m², offers rental of premises of the highest class. The next project to supplement the supply of class "A" office premises will be the business centre "Green Hall" in Upės Street, Žvėrynas which will be opened at the end of 2009. It should also be mentioned that some modern buildings for offices are constructed not for lease purposes but for individual needs, i.e. private or public companies will focus their activities in separate buildings which meet contemporary market requirements (TEO, Hansabankas, the Prosecution Service of the Republic of Lithuania, etc.).

The market for modern offices continues to develop more slowly in other Lithuanian cities (Kaunas, Klaipėda, Panevėžys, Šiauliai) and big changes in supply are not expected in the near future. It should be noted that, although the supply of modern offices has increased significantly in Vilnius, Kaunas and Klaipėda, there are few modern business centres in Šiauliai and Panevėžys, and it is unlikely that this sector will show any noticeable development in the short term. Vilnius (appropriately as the country's capital) remains, and will remain the unambiguous leader in the market for modern offices with regard to supply and rents or sale prices.

Retail

Šiauliai will be the leading city for development among Lithuanian cities in the sector of modern retail premises until the end of 2009. In this city, the total area of modern shopping centres space per capita will amount to over 1 m², i.e. the biggest indicator in all Lithuania. Šiauliai will remain the leader due to the "Akropolis" centre which is near completion and has a total rental area of 34,000 m². Despite the fact that some of the biggest shopping centres in Lithuania "Panorama" and "Ozas" (their rented areas are 50,000 m² and 60,000 m² respectively) will soon be opened in Vilnius, the area of shopping centres per capita in this city will amount to only 0.71 m², or 30% less than Šiauliai. In the years 2008–2009, changes are not expected in Kaunas which was the leader for retail premises from 2007. New shopping centres with an area bigger than 5,000 m² will not be opened in Kaunas in this period. The intensive development of shopping centres in 2005–2007, which ended with the opening of "Akropolis" at the end of 2007, filled all the gaps in the market for shopping centres and did not leave any space for the development of new projects for subsequent years. However, some bigger projects are still in process in Kaunas, i.e. expansion of the shopping centre "Mega" and reconstruction of "Merkurijus", which are planned to be implemented no earlier than 2010.

**Modern retail space per capita
(over 5.000 m² GLA)**



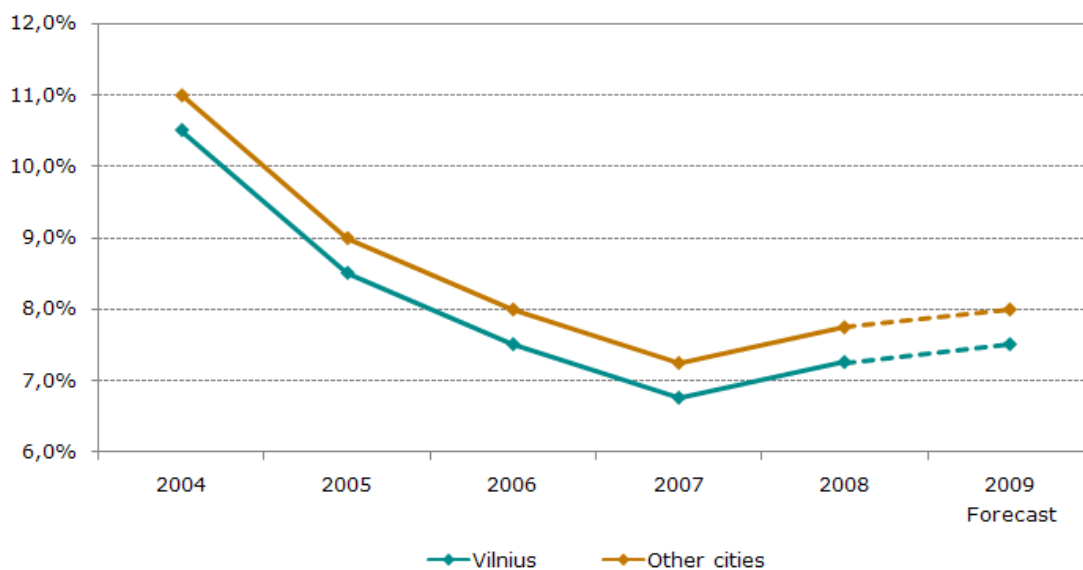
It is likely that rapid development of building of retail premises and a slowdown of economic growth in the future may affect both the occupation of retail premises and their prices in Lithuanian cities. Previously, building owners managed to rent out all their premises before opening. In today's market, however, such a scenario is less probable. Developers will probably not succeed in finding lessees for new projects so easily. Therefore, a growth in rents for retail premises is very unlikely in the near future. It is more likely that rents will remain stable or will even decrease slightly. Lower consumption by the population and growing competition in retail areas will perhaps force the owners of shopping centres to pay more attention to lessees' requirements, to

look for new trademarks or even to change or at least improve the concept of shopping centres in order to guarantee a large flow of customers.

The profitability of commercial property

The problems of worldwide financial markets that occurred in 2007 notably corrected the Lithuanian investment profitability for commercial premises, which had decreased prior to 2007. Investment yields stabilized and started to increase in the third quarter of 2007. Potential buyers of commercial buildings offered a profitability margin of 0.5–1.0 % higher than the previous year, although profitability for building owners did not change radically. At present the investment yields of commercial property, i.e. modern business, shopping and logistics centres, amounts to 6.5–7.5 % on average, subject to city, and particular place and type of property. Growing yields of commercial property imply that the value of property is on the decrease, as a lower purchase price is paid for the same income generated by a property. Considering the fact that the yields have increased by 0.5–1.0 % over the past years, it can be stated that the value of objects of this type (commercial buildings with a tenants) declined by 5–10 % over the last 12 months.

Average commercial property yields



The main reasons for the growth in yields of commercial premises (and the decrease of the value of buildings) are as follows: high interests of loans in the financial market worldwide, and a controversial forecast of our country's economy and the real estate market. This has greatly reduced the interest of large foreign investors in our country. Stabilization of rents in the market of commercial premises has also influenced changes in profitability; previously investors had optimistic views about the growing income which could be generated by a commercial property. However, now they evaluate any potential

future risk (even the decrease of income) more carefully and choose investment projects with greater attention.

In any case, the cooling of the Lithuanian market for commercial premises should remain attractive both for local and foreign investors who believe in long-term real estate perspectives. However, it is obvious that potential investors will choose investment projects more carefully and try to acquire premises for a price acceptable to them. The stricter loan policy of banks and the lack of free money should encourage local real estate owners to make more flexible decisions regarding offers for potential buyers, and offer their property to potential local and foreign investors more actively.

If you wish to receive any additional information about development of the real estate market in Lithuania, Latvia, Estonia, Poland, and Ukraine; or you would like to order a special report on the part of the market relevant to you or the market of the project in progress, please contact UAB Ober-Haus real estate market analysts.

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