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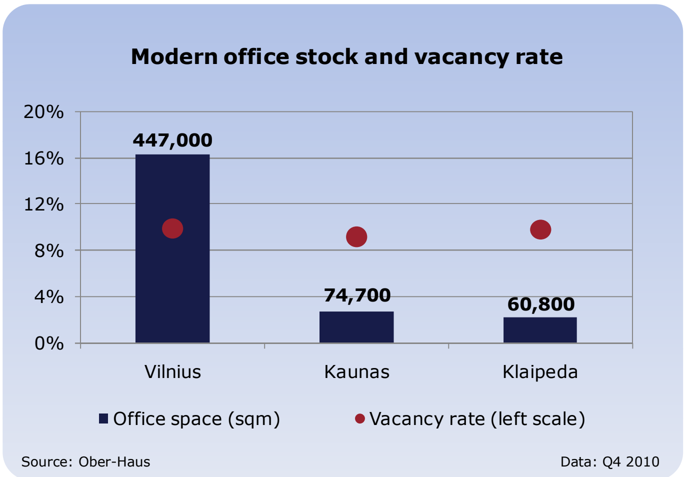
Lithuanian Commercial Real Estate **Q4 2010**

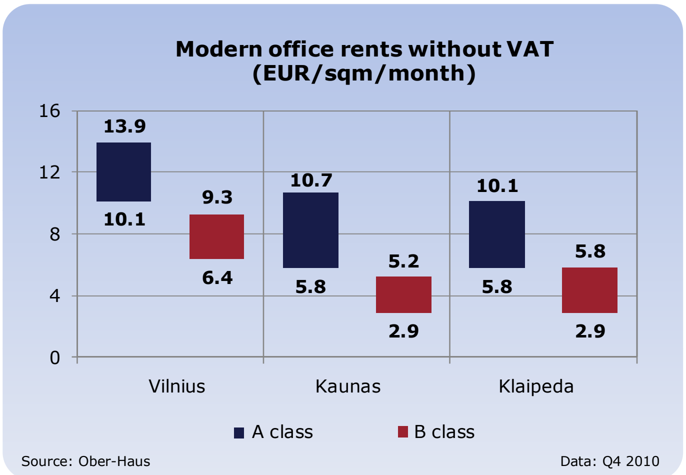
MARKET COMMENTARY

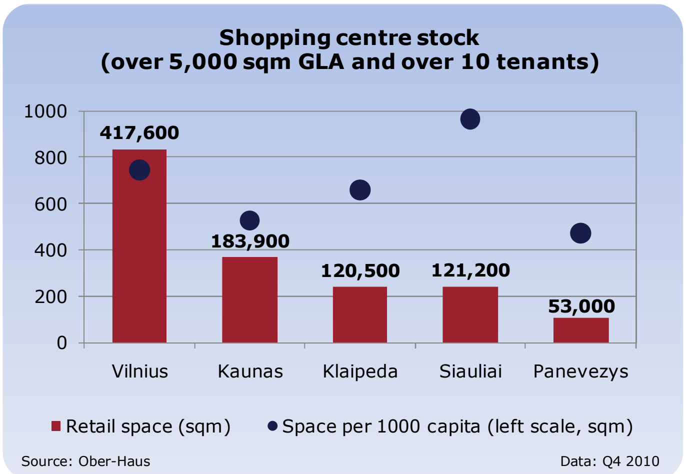
While the situation in 2009 in the Lithuanian commercial property sector can be characterised as a “free fall”, the sector began to show certain stability in 2010 and the situation showed definite signs of improvement as early as the second half of the year. What is so special about the commercial property sector in 2010? First, it is the record low in both sale and rental prices, which have remained stable in the second half of the year in most of Lithuanian cities, with Vilnius, the capital showing some early signs of recovery. Second, market activity is still exceptionally low, closely resembling that in 2009. The only sector showing a higher rate of activity was the modern office rental sector, due to local and new foreign companies alike who are financially stable, taking advantage of the current situation in the market, and who have rented new premises at exceptionally attractive prices. Third, the new supply is at its lowest for 10 years. In 2010, Lithuanian cities have seen a particularly low number of commercial projects carried out, as most of them were suspended, still waiting for a more active market.

Despite the still low strength of the commercial property sector in Lithuania, the first half of 2010 has already seen the first positive changes in the modern office sector. This sector in Vilnius was the first to record a decreasing vacancy rate and increasing rents. Positive trends in the modern offices market in the capital city have also been recorded in Q4 2010.

The vacancy rate of modern offices (class A and B) in **Vilnius** has fallen from **17.7%** to **9.9%** in 2010, with the total area of vacant premises shrinking from 75,500 sqm down to 44,200 sqm. Particular attention was paid by the tenants in class A office premises, with the vacancy rate falling twice over 2010, from 15.1% down to 7.5%. Occupation indicators of class B office premises have also shown marked improvement; however, by the end of 2010, the vacancy rate of such premises, compared to class A, was higher, by as much as 11.5%. Last year has also seen a fall in the number of vacant premises in Kaunas and Klaipėda. **Kaunas** has seen a total decrease in the vacancy rate of modern office premises from **14.9%** to **9.2%,** and **Klaipėda,** from **16.8%** to **9.8%** respectively.



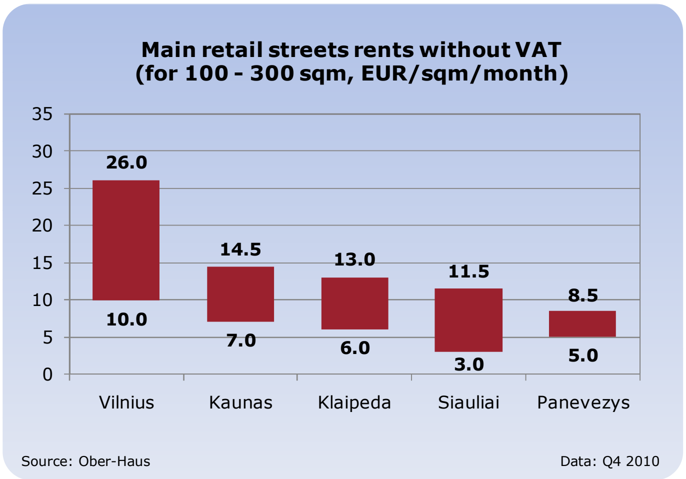


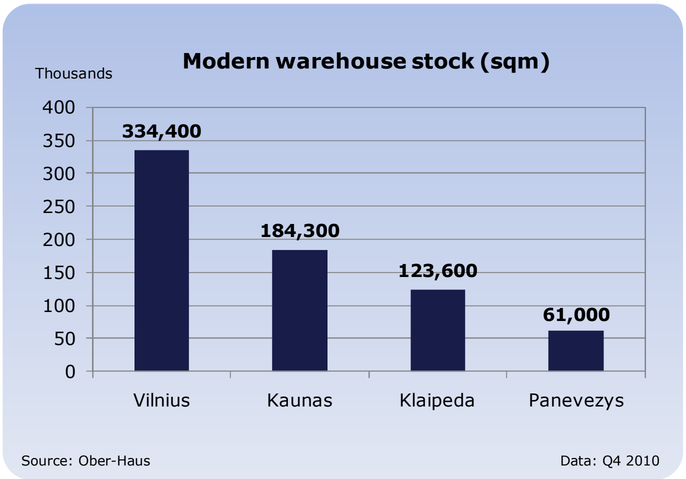


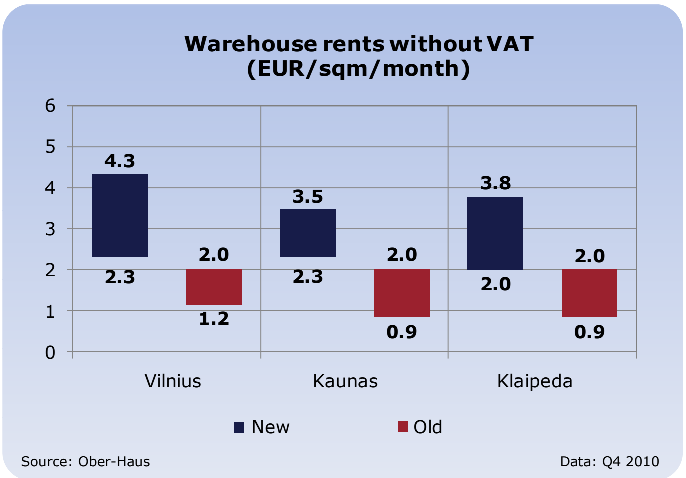
The downwards trend in vacancy rate was brought about not only by the opportunity to rent or purchase premises at a particularly favourable price, but also by the non-existence of new supply. Over 2010, not a single business centre was opened in Kaunas or Klaipėda; Vilnius saw the only opening (Beta business centre). Once this business centre of approximately 20,000 sqm leasable area was built the supply of modern office premises in Vilnius rose to **447,000 sqm**; however, this has not had a negative impact on the occupation indicators, as the business centre is currently fully leased. However, it is unlikely that we shall see a more rapid development in this sector continuing in 2011, with the number of available premises being considerably lower but still sufficient to attract sizeable investment in the construction of new office buildings. It is likely that the year will see completion of currently developed projects or the start of some "built-to-suit" project.

Office rents have seen a double decrease over 2008-2009 with the record low seen at the end of 2009. 2010 can be characterised as a period with prices stabilising or even moderate growth. While the rents of modern offices in Kaunas and Klaipėda has remained practically stable throughout the year, **Vilnius** saw a change of approximately **10-12%** in the respective period, i. e. average 1-1.5 EUR/sqm. Rents of A class offices in **Vilnius** currently ranges from **10.1** to **13.9 EUR/sqm**, and B class ranges from **6.4** to **9.3 EUR/sqm**. **Kaunas and Klaipėda** show a very similar rents level of office premises: class A, from **5.8** to **10.7 EUR/sqm**, and class B, from **2.9** to **5.8 EUR/sqm**. As was already demonstrated in the middle of 2010, as the vacancy rate decreases, owners take advantage in negotiation, allowing for an increase in rate. It is likely, however, that as the area of vacant premises decreases in 2011, with new supply unaccounted for, the rents for modern offices will increase at a rate of 5-15%.

The supply of new retail areas in 2010 was particularly small. Lithuanian cities have only seen very few new projects carried out (Link Molėtų shopping centre in Vilnius and Prisma grand centre in Kaunas). A comparison of Lithuanian cities based on the area of shopping centres per city residents reveals that Lithuania has not seen significant changes over 2010.



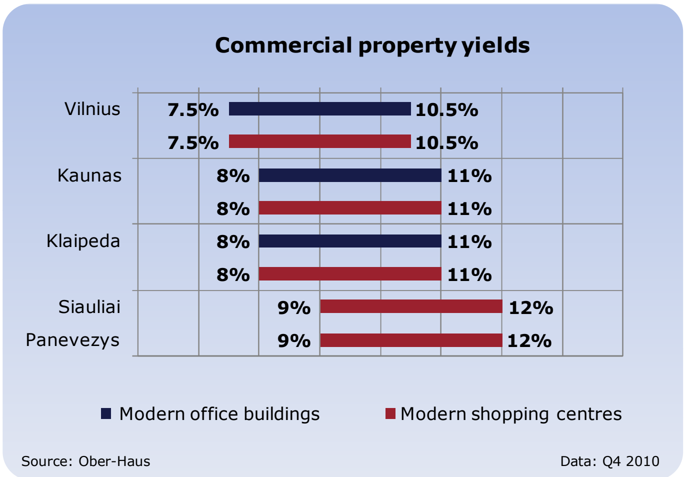




Šiauliai is still leading in this respect with 1,000 Šiauliai residents per **966 sqm** area. Vilnius, following the opening of another shopping centre, has enhanced its position and there are now 1,000 Vilnius residents per **745 sqm** in shopping centres. The remaining Lithuanian cities follow: **Klaipėda, Kaunas, and Panevėžys** (**659 sqm, 528 sqm and 473 sqm** respectively).

The minimum development of the retail sector represents a natural response to reduced consumption. The owners of premises in shopping centres have had to take drastic changes with respect to rents in order to fill the vacant premises or to retain current tenants. The overall situation in shopping centres is not particularly alarming. For example, the area of available premises in Vilnius shopping centres has decreased from **5.7%** to **4.5%** over 2010. However, shopping centres are now in a different position, with managers of certain shopping centres enjoying full occupancy, while others only ensure occupation rates of 70-90%. It is still likely that 2011 will bring good news for owners of large commercial areas and for individual premises alike. One may speculate that the year will record the first real positive changes in retail turnover, which will also have an effect on the record low prices.

2010 has not proved successful for the warehousing premises sector. Over the year the rents of both new and old warehousing premises in **Vilnius, Kaunas and Klaipėda regions** have seen an average decrease of approximately **10%** (with 2009 fall of rents of approximately 35-40%). New warehousing premises are now offered for rent in **Vilnius** at **2.3–4.3 EUR/sqm**, and of old premises of **1.2–2.0 EUR/sqm**. **Kaunas** and **Klaipėda** show rents of new warehousing premises at **2.0-3.8 EUR/sqm**, and the rents of old premises at **0.9-2.0 EUR/sqm²**. Given the sharp decrease in the sale and rent prices and negligent demand, investors have refused to open new warehouses for lease in 2010. The key reason for the negligible demand is consumption that is still low which prevents sellers from warehousing excessive



production or searching for new areas. It is unlikely that 2011 will see rapid development in this sector as this would only be possible if there was stable and considerable recovery in the national economy and an increase in consumption.

Although higher activity on the part of investors was expected in purchasing commercial objects for generating cash flows, the year 2010 only saw one bigger transaction. The Lords LB Baltic Fund I, local investment fund established in 2009, has acquired an office building of 8,500 sqm useful area of A class in Vilnius in the middle of 2010. While the details of the transaction were not disclosed, this was however the first bigger investment transaction in Lithuania in almost 2 years. The absence of larger investment transactions was caused by incompatibility between the expectations of owners and potential buyers, with the price asked by the owners not meeting the expectations of buyers and vice versa. Hopefully, the stability in national economy and real estate market; a constructive approach to the situation from both sides of the transaction will finally facilitate mutual dialogue and 2011 should see more transactions of this sort. It is likely that current investment transactions, depending on the type of property, could ensure yields of **7.0%** to **10.0%** in **Vilnius,** with a slightly higher risk of 0.5%-2.0% in other major Lithuanian cities.

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