OBER HAUS

COMMERCIAL REAL ESTATE MARKET COMMENTARY

LITHUANIA / H1 2020

INVESTMENT MARKET

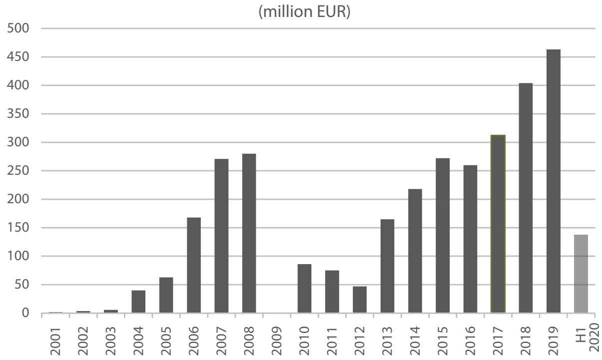
The latest data and surveys from multinational companies show that in the face of the pandemic commercial real estate investment markets are experiencing negative developments to a greater or lesser degree on a global scale. For example, according to the real estate services company Jones Lang LaSalle, a decline of one-third year-on-year in investment in commercial real estate was recorded in H1 2020 in the Asia-Pacific region. In Europe, the overall investment volumes in real estate remained high in H1 2020, but significant negative developments are already taking place in H2.

According to Ober-Haus, the overall indicators of commercial real estate investment market in Lithuania in H1 2020 were not impressive and fell below long-term average. In H1 2020, acquisitions of modern commercial property (office, retail and industrial buildings/premises with a value of at least EUR 1.5 million) totalled **EUR 138 million** in Lithuania. Due to the relatively small size of the Lithuanian commercial real estate market and lower liquidity, which leads to large fluctuations in activity in a shorter period, it is difficult to compare even half-yearly results. For example, in H1 2019, investment transactions (finalised) totalled EUR 77 million in Lithuania. This was the poorest half-year indicator since 2013. However, in H2 2019, the situation was the opposite and the most active half-year in the investment transactions market in Lithuania was recorded bringing the annual total to EUR 463 million.

Comparing the results of H1 2020 with the historical indicators, the amount of investments is 19% lower than the five-year average (2015–2019). The investment market is inert – sometimes it may take a year or even longer from a strategic decision to acquire a particular property to its acquisition, so judging by the results of H1 it is still difficult to assess the impact of the pandemic on this sector. But one thing is obvious – the vast majority of investments in H1 2020 was determined by previous agreements for the acquisition.

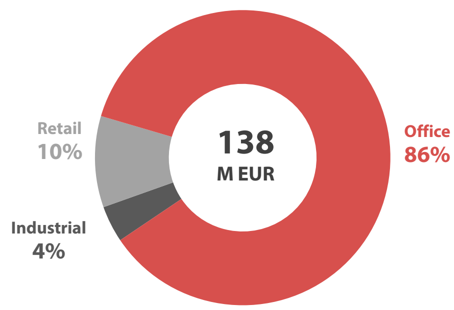
Like in the previous year, the major part of investments in Lithuania (86% of the total amount) accounted for the acquisitions of office buildings. In H1 2020, one of the largest office transactions in the history of Lithuania was finally completed when the third S7 office building was purchased by the Swedish investment company Eastnine. At the beginning of 2019, Eastnine signed an agreement with Galio Group regarding the acquisition of three S7 office buildings in Vilnius and these acquisitions were completed in stages (after the construction of each building was completed and the tenants moved into the building). In mid-2020, another large-scale transaction was announced, which had already been agreed in previous years. Investment company Zenith AM (jointly managed by Zenith Family Office and Dao Family Office) acquired the second building of the Park Town (East Hill) in

COMMERCIAL PROPERTY INVESTMENT VOLUMES IN LITHUANIA
(million EUR)



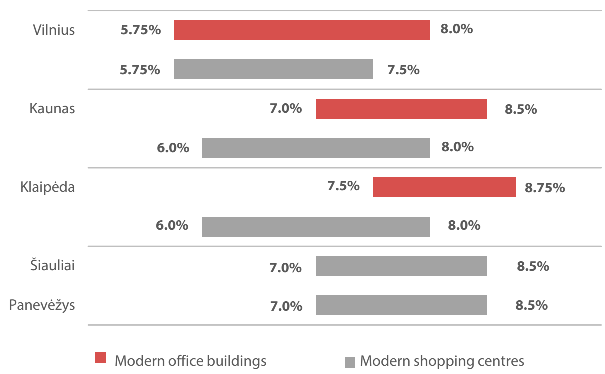
Source: Ober-Haus

COMMERCIAL PROPERTY INVESTMENT VOLUMES BY SECTOR LITHUANIA



Source: Ober-Haus / H1 2020

COMMERCIAL PROPERTY INVESTMENT YIELDS



Source: Ober-Haus / H1 2020

Vilnius from Darnu Group. The total value of these two transactions is EUR 86 million or 62% of the total investments in H1 2020.

The third largest investment transaction in the first half of 2020 was also executed in Vilnius. At the end of 2019, fund controlled by Lords LB Asset Management announced of its intention to acquire the IBC office building complex managed by INVL Baltic Real Estate. This EUR 33 million acquisition transaction was completed in March 2020.

Acquisitions of smaller retail and industrial properties in the country's capital and other cities of Lithuania, which ranged between EUR 3–6 million, accounted for the remaining part of the total H1 investment (EUR 19 million or the remaining 14% of all investments in H1 2020).

Surveys of the global market participants show that investment volumes in particular segments (offices, logistics) are expected to grow in H2 2020. Meanwhile, expectations for the retail property sector are much more moderate and market participants expect recovery in 2021 at the earliest. Looking at the results of H1 2020 in Lithuania and the caution regarding the prospects of the country's economy as well as the real estate development in the near future, it is very difficult to expect bolder steps by investors in both Lithuania and the Baltics. In Q2 2020 of this year, due to the existing situation, both the buyers and sellers of commercial property remained passive, which means that strategic decisions regarding acquisitions made in H2 2020 will be reflected in the transaction statistics at the end of the year or in 2021.

Therefore, it is currently very difficult to expect another very productive year in the Lithuanian investment market and it is very likely that the total annual volumes of investment transactions this year will return to the level of 2014–2016 (EUR 220–270 million). Unless the overall performance will be significantly improved by a larger investments in the office segment, as we have seen it in recent years. Despite the growing popularity of work from home, the higher class office segment is expected to remain among the most coveted investments among potential investors. Rapidly built office projects in Vilnius and Kaunas will offer a wider choice of quality properties compared to other real estate segments, especially if such offices have financially strong tenants resistant to the pandemics like Covid-19.

PARK TOWN (WEST & EAST)

OBER HAUS

COMMERCIAL REAL ESTATE MARKET COMMENTARY

LITHUANIA / H1 2020

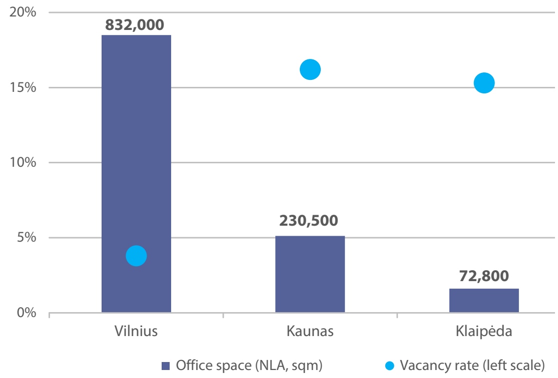
OFFICE MARKET

Despite the challenges brought by the current pandemic to the entire economy and at the same time to the real estate market, the modern office sector in the major cities of Lithuania has not seen significant changes in H1 2020. After the end of the lockdown, the employees partly or fully returned to the vacated offices. The construction of projects successfully continues and the increase in office vacancies in business centres was due to the opening of newly completed projects. Meanwhile, the widely tested remote work opportunities have given rise to various considerations about the future prospects of offices: from declining overall demand for physical office space to increasing it to expand social distancing space for on-site employees.

The uncertainty caused by the virus and the changing global situation are encouraging companies to try out different business models in their offices. It is likely that in the near future it will be difficult to identify the office planning strategy that tenants will choose, as the current global health and economic crisis is still ongoing. However, regardless of when this crisis is going to be finally resolved, companies will anyway have to provide their employees with safe places of work. Looking at the history of modern offices in the major cities of Lithuania, the share of office rent and maintenance expenditure in the total operating expenses of the companies is decreasing. Thus, in the long run it is unlikely that companies competing for labour force will decide to significantly reduce their office space further reducing social distance space between employees or asking some of them to work from home. Therefore, financially strong companies will make every effort not to reduce the comfort of employees or their work efficiency. And with the current crisis still ongoing, the decision to reduce some or all office space is likely to be made due to financial problems of the companies, but not to changes in the organization of work.

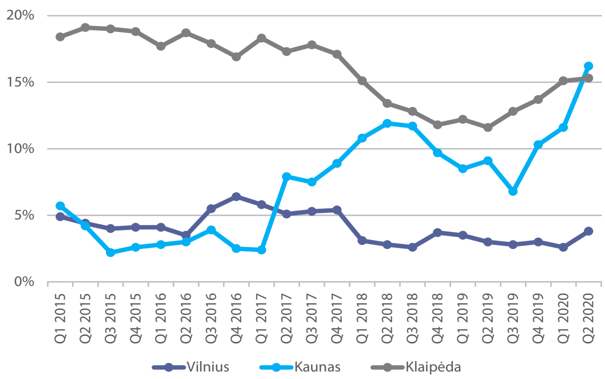
In H1 2020, the construction of five office buildings was completed in Vilnius: Green Hall 3, U219, Uptown Park, SEB headquarters and the business centre in the multifunctional Paupys complex. These projects supplemented a total of 47,600 sqm of useful office space to the office market of the capital city, and the total modern office space in **Vilnius** increased by 6% to **832,000 sqm** in H1 2020. The abundant supply of new space and active tenants also determined high take-up rate. Rented modern office space in H1 2020 in the capital city totalled 66,700 sqm or 20% more than in H2 2019. At the same time, the significant number of newly completed projects has slightly **increased** the vacancy rate in the existing office buildings. In H1 2020, the vacancy rate in the country's capital increased from 3.0% to 3.8%. The vacancy rate for A class offices was 2.0% and for B class offices – 5.2%. The last time the higher vacancy rate of office space was recorded in Vilnius at the end of 2017 and amounted to 5.4%.

MODERN OFFICE STOCK AND VACANCY RATE



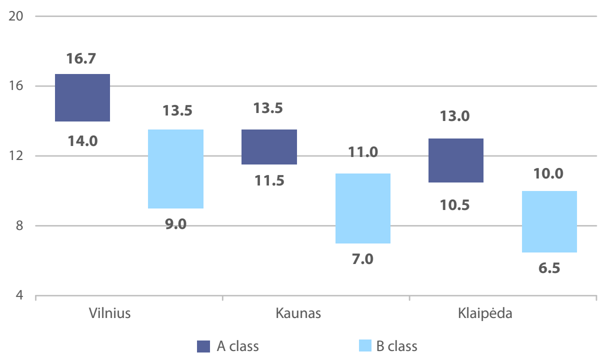
Source: Ober-Haus / Q2 2020

MODERN OFFICE VACANCY RATE



Source: Ober-Haus

MODERN OFFICE RENTS
(EUR/sqm/month, without VAT)



Source: Ober-Haus / Q2 2020

In H2 2020, a large number of new projects will be offered to the market – six more new buildings should be completed in the capital city and the modern office space market in Vilnius will be supplemented with 51,300 sqm of useful office space. If these projects, which are currently being completed or are nearing completion, are implemented as planned, the total area of new offices that will supplement the market in Vilnius in 2020 will be the largest in history totalling almost 99,000 sqm. To date, the year 2008 was considered a record year, when the construction of 11 projects with total useful office space of 86,500 sqm were completed.

Office rents in the country's capital in H1 2020 remained stable and currently rents for B class offices stand at **9.0–13.5 EUR/sqm** and rents for A class offices stand at **14.0–16.7 EUR/sqm**. Even before the current pandemic, the prospects for increase in office rents were extremely vague, because particularly large volumes of new premises offered to the market each year did not allow developers to increase office rents. Meanwhile, the current situation has further reduced the likelihood of increase in office rents, as tenants are currently more cautious and less optimistic about expanding their activities and increasing the rented space. It is likely that in the next 12 months the pressure from tenants to reduce rents will intensify and some property owners will be forced to adapt to the changed situation and offer tenants more attractive rental terms than their competitors.

Developers in Kaunas also remain extremely active and for the fourth consecutive year offer more than 30,000 sqm of useful office space. In H1 2020, four new projects were completed in Kaunas with 31,000 sqm of useful office space offered to the market. The total area of modern office premises in **Kaunas** in H1 2020 increased by almost 16% totalling **230,500 sqm**. In mid-2020, the construction of the largest business centre was completed in Kaunas – Magnus has offered about 18,000 sqm of office space to the market. To date, the largest modern office project in Kaunas was the Senukai administrative building built in 2013, with useful office area of just over 15,000 sqm. No major changes in supply are expected in Kaunas in H2 2020, as only one small commercial project is planned to be completed which will provide about 1,200 sqm of offices.

Large volumes of new office space that opened in Kaunas at one time increased the level of office space vacancies to a record ten-year level. Between the end of 2019 and mid-2020, the overall vacancy rate of modern office space in the city **increased** from 10.3% to **16.2%**. The vacancy rate for A class offices amounted to 20.4% and for B class offices – 14.1%. This means that in the middle of this year, tenants in Kaunas could choose from the available record high completed office space of over 37,000 sqm.

The total amount of rented modern office premises in Kaunas in H1 2020 was 16,500 sqm or 6% less than the average of the last three half-years (2017–2019). Considering that the construction of larger projects is not scheduled for completion in H2 2020 or H1 2021 in Kaunas, and the demand remains essentially stable, the vacancy rates should decrease again during this period. Such fluctuations in the vacancy rates of office space have been recorded in Kaunas before.

The considerable increase in vacancy rates in Kaunas in H1 2020, and the postponed, at least temporarily, development plans by businesses in Kaunas at the height of the pandemic, slightly reduced office rents. In H1 2020, rents for A class office premises in Kaunas **decreased** on average by about 2%, while rents for B class office premises remained stable. In the mid-2020 rents for B class offices stood at **7.0–11.0 EUR/sqm** and rents for A class offices stood at **11.5–13.5 EUR/sqm**. Taking into account the current situation in the office market in Kaunas and the cautious approach of businesses to any further expansion of operations, office rents in the second half of this year should remain stable with a slight decrease in certain projects.

The modern office market in Klaipėda continues its quiet period. In H1 2020, no new projects with office space were built. The area of modern office premises in **Klaipėda** has not changed since Q3 2019 (when a new commercial building with office premises was opened on Dubysos Street) and in mid-2020 totalled **72,800 sqm**. Despite various initiatives and plans to invest in the construction of office buildings in Klaipėda, the planning process has been very slow and projects often remain only on paper. It is therefore unlikely that we will see any real impetus in the development of the office segment in this city in the near future.

The vacancy rates of office space in Klaipėda in H1 2020 **increased** from 13.7% to **15.3%** and looking at the previous year the direction is not clear, i.e. in 2017–2020, it has ranged between 12–18%. In H1 2020, rents for modern office premises in Klaipėda remained stable. In mid-2020, rents for B class offices stood at **6.5–10.0 EUR/sqm** and rents for A class offices stood at **10.5–13.0 EUR/sqm**. It is likely that a similar level of rents will remain in Klaipėda in the near future – there are almost no incentives for rent increase and the current relatively low level of rents compared to Vilnius or Kaunas no longer solves the fundamental problem, i. e. the lack of potential tenants. Even if the rents are reduced, the number of potential tenants is unlikely to increase.

RETAIL MARKET

In Q2 2020, it was very obvious what challenges the entire retail and retail space sector was facing in Lithuania: essential closure of the major shopping centres, empty city streets and closed operations of small traders. It was really strange to see how the shopping streets of Vilnius, which attract the largest flows of people, became deserted. Last time similar moods prevailed was at the peak of the global financial crisis in 2010, when 15–20% of the premises in the main shopping streets of Vilnius (Gedimino Avenue, Pilies Street, Didžioji Street, and Vokiečių Street) were closed. However, as the country's economy began to recover, businesses returned to the shopping streets of Vilnius and within two years (in mid-2012) the vacancy rates of the retail space in these streets fell to 7.6%.

What was the mood of retailers and the situation in the retail space sector in the shopping streets of the largest city in the country after the end of the lockdown? A survey on the situation in the main shopping streets of Vilnius conducted by Ober-Haus at the end of June 2020 provides an opportunity not only for a detailed overview of the current situation, but also for an assessment of the structural changes that have taken place in the central part of the city over the past eight years. An identical study was also conducted in mid-2012.

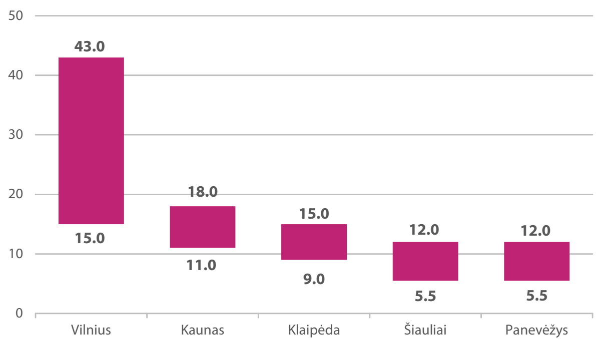
With the official end of the lockdown in mid-June this year, most retail space occupiers rushed to resume their operations. However, depending on the area of their activity, some delayed restarting their operations or were forced to close down altogether, as a result, the owners of the premises had to look for new tenants for the vacated premises. In mid-2020, the vacancy rate in these streets stood at **11.0%**. It is important to note that vacant premises were considered those premises that had the essential characteristics of the vacancy: they were empty, vacated by former tenants or were officially or unofficially advertised as available for rent. The highest vacancy rate was recorded in Vokiečių Street (12.5%) and the lowest in Didžioji Street (7.3%). The vacancy rate in Gedimino Avenue stood at 11.8% and in Pilies Street – at 11.3%. Looking at the historic data concerning Vokiečių Street, this street has been undergoing significant changes. First of all, during the past eight years the vast majority of tenants have changed and it is likely that we will see further changes in this street when the reconstruction of the street initiated by Vilnius city municipality starts.

Although the vacancy rate is higher now than eight years ago, the number of retail units in these streets (located on the ground floor of the building, with at least one window facing the street and suitable for commercial activities) has increased by almost 11%. In mid-2012 there were 264 such units, in mid-2020 – 292. Thenumber of retail premises has increased as over the past eight years new buildings were built or old buildings were reconstructed on these streets or some of the premises were divided into smaller units, etc. Therefore, despite the higher vacancy rate, the number of retail or services units operating on these streets is higher than before.

The most interesting and noticeable are however the structural changes in these streets. The large shopping centre development boom in the country's capital prior to 2009 changed the face of shopping streets. Since then, the number of stores selling clothing, footwear or accessories has decreased and they are being replaced by tenants providing entertainment, food catering and other services. Since 2012, the share of tenants selling clothing and footwear on these streets has fallen from 20.1% to 18.3%, while the share of restaurants, cafes, bars and fast food outlets has risen from 28.9% to 38.6%. In mid-2020, a little over 100 units providing various food and drink services were operating on these four streets.

Meanwhile, the share of food stores decreased from 5.6% to 3.8%, jewellery, accessories, souvenirs and cosmetics retailers decreased from 16.1% to 15.3%, and the share of the rest of the tenants (beauty salons, offices, pharmacies, banks, bookstores and other retail or services units) decreased from 29.3% to 24.0%. The decrease in the number of financing (banks, credit unions) customer service units is however most noticeable. If in mid-2012 there were 15 such units in the major shopping streets in Vilnius, so currently there are only 3.

MAIN RETAIL STREETS RENTS
(for 100 - 300 sqm, EUR/sqm/month, without VAT)



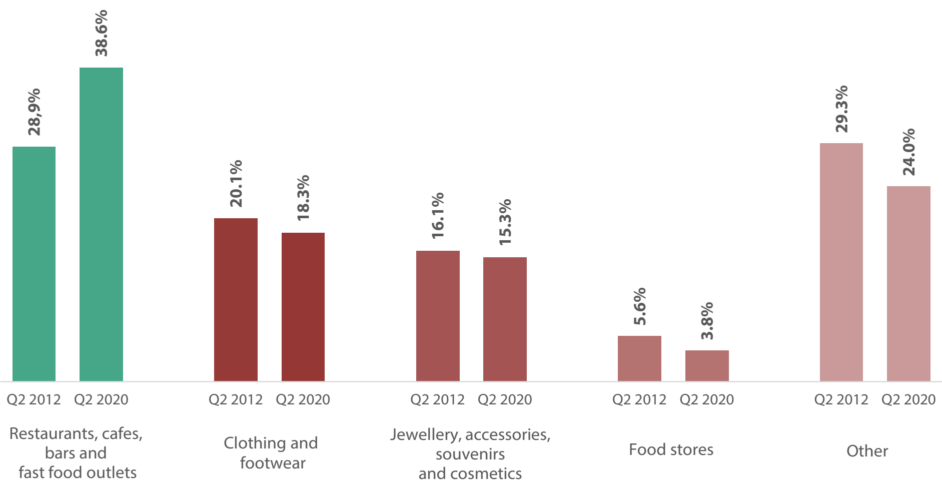
Source: Ober-Haus / Q2 2020

The ever-expanding opportunities for online shopping also determine noticeable changes in the shopping streets of the cities. Therefore, retailers in these streets face at least several challenges at the same time: reduced target flows of buyers, high rents of the premises and not flexible lease terms and conditions. For example, if some tenancy agreements in supermarkets are fully or partially linked to the turnover of the tenants, so in the shopping streets a fixed rent is usually agreed between the owner and the tenant. There is currently a global debate about what typical shopping streets will look like in the future, but there is general consensus that such streets will increasingly need to focus on a variety of services and experiences (food catering, entertainment, education, leisure and cultural activities, flexible workplaces, pop-up shops, etc.) rather than on traditional trade.

The lockdown and clear decline in tenants' expectations for the future have also adjusted rents for retail premises in Q2 2020. In mid-2020, rents for medium-sized (about 100–300 sqm) retail premises in the main shopping streets of **Vilnius** (Gedimino Avenue, Pilies Street, Didžioji Street and Vokiečių Street) stood at **15.0–43.0 EUR/sqm** and were on average **6% lower** than those at the end of 2019. Meanwhile in Kaunas, Šiauliai and Panevėžys rents for retail premises in the mainshopping streets of the cities **fell by 3–5%** in H1 2020, while in Klaipėda they remained largely stable. In mid-2020, rents for medium-sized retail premises in **Kaunas** stood at **11.0–18.0 EUR/sqm**, in **Klaipėda** – **9.0–15.0 EUR/sqm**, and in **Šiauliai** and **Panevėžys** – at **5.5–12.0 EUR/sqm**.

Tenants and owners of retail premises were the first in the commercial real estate market to experience the consequences of the current pandemic and quarantine on their business. The abrupt closure of the business and vague prospects for the future forced many tenants to request for significant discounts from landlords, and some were even forced to close down altogether. Despite the end of the lockdown and the resumed activities, potential tenants of retail premises are much more cautious about their future prospects and see much higher risks than before the pandemic. As a result, landlords are also forced to reconsider their pricing and negotiate with long-term tenants on more flexible terms than before. As the virus and the various business constraints associated with it have not disappeared, and the situation may quickly change for the better or for the worse, retail property segment may face some challenges in H2 2020 also.

TENANTS DISTRIBUTION BY SECTOR IN MAIN RETAIL STREETS OF VILNIUS
(Gedimino Ave., Vokiečių St., Didžioji St., Pilies St.)



Source: Ober-Haus