OBER HAUS
REAL ESTATE ADVISORS

COMMERCIAL REAL ESTATE MARKET COMMENTARY

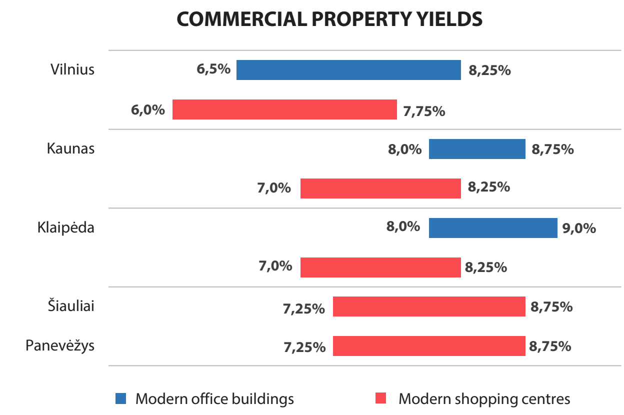
LITHUANIA / Q3 2016

Assessing the general development trends of commercial property in Lithuania, it can be seen that currently the eyes of commercial property developers are essentially focused on only certain segments and certain cities – Vilnius and Kaunas. In Vilnius, the office and hotel segments are the subjects of special attention, whereas in Kaunas, it seems that there is a real boom in the construction of office projects. In other regions of the country, investments in the development of commercial property are substantially scarcer – generally, we see the construction of grocery and construction materials' shops, as well as the renovation of already-existing shopping centres or a few industrial purpose projects in the free economic zones of Lithuania. Seeing that the number of commercial projects developed for market needs (seeking to lease or sell them) depends directly on the economic prospects of the regions, it makes sense that recently developers have been concentrating their investments on the centres of the strongest regions and we are unlikely to see this trend changing in the short run.

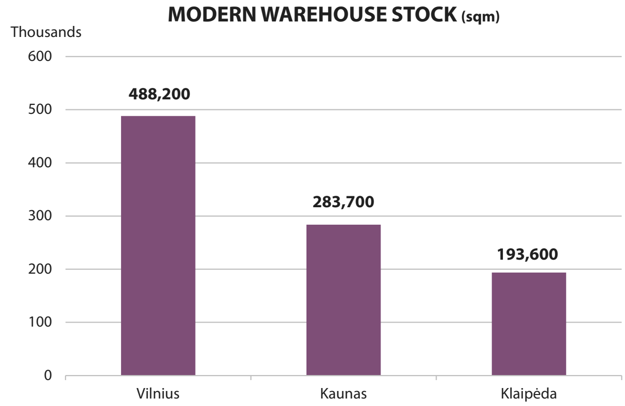
For the last five years, the warehousing and logistics sector has been and remains one of the "neglected" real property segments among developers. The rather uncertain demand for warehousing premises, specific requirements of tenants (location and technical parameters of the building) as well as the slow down in the growth of rents fail to create favourable conditions for developers to plan new projects. However, financial indicators of this sector, at least recently, have been stable. According to the data of Statistics Lithuania, during the first six months of 2016, sales revenues of warehousing and storage companies (excluding VAT) amounted to EUR 60.8 million or respectively 0.3% and 10.1% more compared to the same period of 2015 and 2014. Nevertheless, comparison of the indicators for the first half of this year with the same period of 2012–2013 shows that sales revenues of warehousing and storage companies have fallen by 14% on average.

However, as property developers view this sector indifferently, it cannot be said that the development of warehousing buildings has stopped altogether: financially stronger companies implement projects that meet their needs themselves. Over the nine months of 2016, six new warehousing projects have been built in **Vilnius, Kaunas and Klaipėda regions**, with the total warehouse area comprising approximately **33,200 sqm**. The largest number of projects were implemented in Vilnius region (Layher Baltic, Litcargus, Woodline, and Wirtgen Lietuva) and the total area of warehousing premises at the end of the third quarter of this year increased to **488,200 sqm**. In the middle of this year, Volfas Engelman brewery opened a warehouse for its products in Kaunas, thus increasing the total area of warehousing premises in this city to **283,700 sqm**. The largest warehousing project was implemented this year in Klaipėda district – a warehouse of 17,500 sqm with office premises was constructed by VPA Logistics, and the total area of warehousing premises in Klaipėda region went up to **193,600 sqm**. Four of those projects were built and intended exclusively for the needs of the companies engaged in their development.

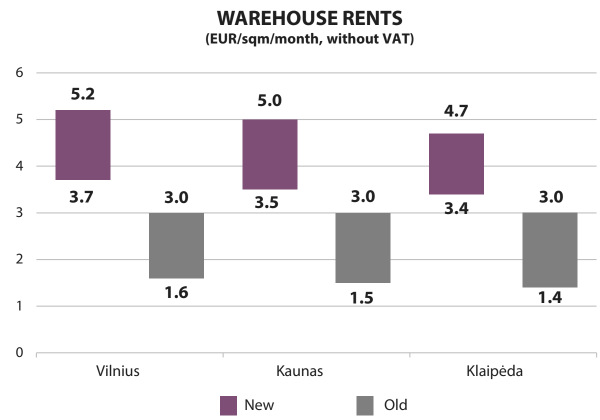
In 2017, at least 3 larger warehousing projects (or their stages) with a total area of 34,000 sqm should be implemented in Vilnius. These projects are being developed by Baltic Sea Properties, Ad Rem and Sirin Development. In the meantime, in Kaunas, a logistics centre for Aibė, the trading companies alliance, is under construction with the opening planned for July 2017.



Source: Ober-Haus / Q3 2016



Source: Ober-Haus / Q3 2016



Source: Ober-Haus / Q3 2016

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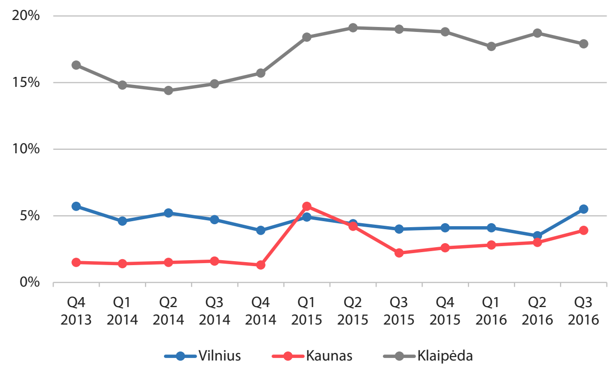
Over the last 12 months, the rents of new and old warehousing premises in Vilnius region have increased by **only 2-3%**, whereas **in Kaunas and Klaipėda regions** the rents of warehousing premises remained unchanged. At present, warehousing premises of new construction **in Vilnius** are offered for rent at **3.7–5.2 EUR/sqm**, old construction – at **1.6–3.0 EUR/sqm**. **In Kaunas,** new warehouses are offered at **3.5–5.0 EUR/sqm**, old ones – **1.5–3.0 EUR/sqm**, while **in Klaipėda** new warehouses go for **3.4–4.7 EUR/sqm**, old ones – **1.4–3.0 EUR/sqm**. The stagnation of rents for warehousing premises also slows down the more active development of this sector. The rapid rebound of rents of new warehouses from the latest lowest level in 2010 has been notably slower in recent years. From the end of 2014 (for almost two years) the rents of new warehousing premises in Vilnius, Kaunas and Klaipėda regions have increased on average by 3-4%. In contrast, rents of office and retail premises in the same regions over the same period increased by 8–10% on average.

In the meantime, long-awaited changes are seen in the sector of modern office premises. In Vilnius, 2 new business centres were completed in the third quarter of this year (business centre CITY at Žalgirio St. and the first stage of Quadrum at Konstitucijos Ave.), which became the first business centres opened this year in the capital city. Simultaneously, the market was supplemented by 42,500 sqm of useful office area and this also influenced the occupancy rates. Although the major share of premises have already been rented as on the opening date of these business centres, the remaining unoccupied area in the two business centres (about 14,000 sqm) increased the vacancy rate **in Vilnius** business centres during the third quarter of this year from 3.5% to **5.5%** (i.e. to 32,400 sqm). Albeit the interest in office premises at new business centres remains rather high, the growth in vacancy rate will persist further. Four new projects should be launched by the end of this year in the capital city with the useful area of office premises amounting to 38,300 sqm.

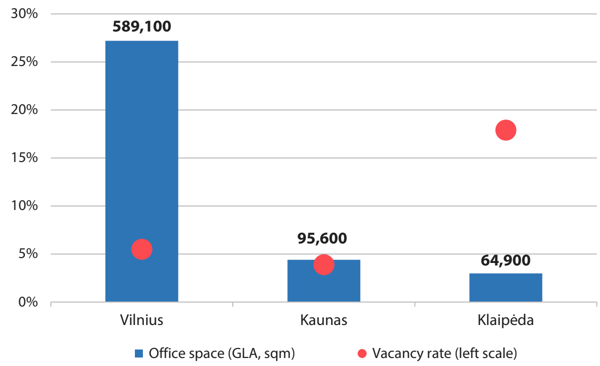
Currently, in Vilnius, the occupancy rates of new office premises remain at a high level and are shown by the numbers of premises let. During the nine months of this year, **41,200 sqm** of area have been rented in Vilnius business centres, representing an **increase of 2%** compared to the same period in 2015. The leap of new supply is also going to increase the take-up of office premises this year. Ober-Haus forecasts that this year about 70,000 sqm of modern office premises will be let in total (more by a third than in 2015). However, even greater challenges await the office premises market in the coming year. In 2017, the developers plan to offer the market another 85,000 sqm of useful area of premises through 15 projects (or their stages). Almost all of the new projects are in the construction stage; consequently, the resulting area of premises is highly likely. If the market maintained the same office occupancy rates as this year, we could expect a sustainable development of this sector even with the current leap of supply. It is obvious that service centres of international companies expanding particularly rapidly in the capital city determined such a leap of supply and demand; however, it is rather difficult to anticipate their further expansion or the coming of new companies to the market of Lithuania. As can be seen from examples of projects pursued this year, newly opened business centres are not fully occupied on their opening dates and it is therefore likely that we will continue to see the newly launched projects increasing the vacancy rates.

MODERN OFFICE VACANCY RATE



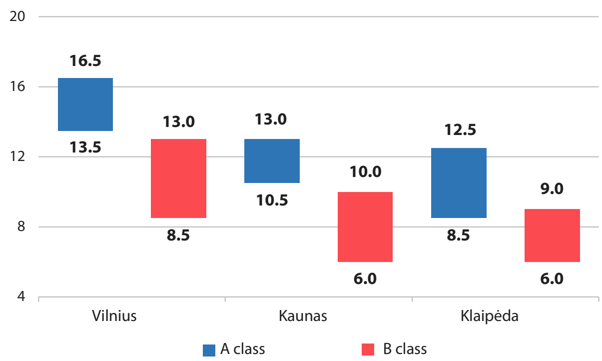
Source: Ober-Haus / 2013 - 2016

MODERN OFFICE STOCK AND VACANCY RATE



Source: Ober-Haus / Q3 2016

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



Source: Ober-Haus / Q3 2016

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A broad choice of office premises in Vilnius city is blocking the growth of rents that until now has been rapid. Over the first six months of this year, the rents of modern office premises in Vilnius went up by only 1% on average, whereas in the third quarter of this year, no changes in rents have been recorded. For comparison, in 2012–2015, the rents of modern offices in Vilnius have been increasing on average by 5% annually. Currently, in the capital city, offices of B class are offered for rent at **8.5-13.0 EUR/sqm**, A class – **13.5-16.5 EUR/sqm**. Nowadays developers infrequently talk about the increase of rents at office buildings operated by them, especially in case of projects under construction where they are eager to let as much of the area as possible before the completion of construction.

Finally, a breakthrough can be seen in the market of modern office premises in Kaunas. During the third quarter of this year, 3 small projects were completed (Daimonda at Taikos Ave., building on Pramonės Ave. and another building on Partizanų St.), offering almost 4,400 sqm of office premises to the market. The total useful area of modern office premises in Kaunas went up to **95,600 sqm**. The newly offered projects also slightly increased the vacancy rates in Kaunas city: from 2.1% to **3.9%** during the third quarter of this year. Nonetheless, the current vacancy rate remains the lowest among the three largest cities of the country, whereas the total area of vacant office premises comprises only 3,750 sqm. By the end of 2016, two more office projects or their stages should be completed in Kaunas (Prospekto Verslo Parkas at Vytauto Ave. and Elsis administrative building at Taikos Ave.). Upon completion of these projects, in total 6 different office projects will have been implemented in Kaunas in 2016 with a total area of office premises of 10,400 sqm.

Seeing the shortage of modern office premises in the second largest city of Lithuania while the expanding companies build the buildings themselves and the international companies establish their service centres in Vilnius, the developers decided not to miss the chance. It can be stated that the developers simultaneously decided to deal with the shortage of modern office premises in Kaunas city. The plans of the developers are indeed ambitious and real implementation has already started. The news about the office project Magnum at the site of unfinished development of Respublika Hotel attracted the greatest attention. Moreover, construction of another business centre Arka has also been commenced next to Magnum project. Just these two projects in the central part of Kaunas city could offer 20,000 sqm of modern office area. Although some of the premises in these projects are already booked by the developing companies, the major share of them are offered on the market.

Around the same time (end of 2017 – beginning of 2018) a company controlled by SBA Concern also plans to implement 2 large projects in Kaunas. The projects at Jonavos St. and K. Donelaičio St. will be able to offer yet more than 20,000 sqm of useful office area to Kaunas market. However, local and international companies will be able to choose from an even broader supply, seeing that it is planned to build 7 more administrative projects in 2017–2018, besides the mentioned ones (at Savanorių Ave., Jonavos St., A. Juozapavičiaus St., K. Baršausko St., Vytauto Ave. and Studentų St.), which should offer another 18,000 sqm of useful office area. In summary of the situation in Kaunas office market, it can be seen that during the coming few years the developers intend to increase the current office stock in Kaunas by as much as 60%.

It is obvious that the developers in Kaunas try to emulate Vilnius and increase the competition in the office market of this city as well as challenge the capital city. The expansion of local companies in Lithuania is not notably rapid and only financially strong companies can afford to rent office premises in modern business centres (currently **in Kaunas** offices of B class are offered for rent at **6.0-10.0 EUR/sqm**, A class – **10.5-13.0 EUR/sqm**); as result, companies developing their projects in Kaunas probably expect that the service centres that are still undergoing expansion in Lithuania will decide to establish themselves in Kaunas too – previously, when the supply of office premises was not vast, this was hardly likely. The total development potential of office premises in Vilnius and Kaunas cities during the period of 2017–2018 constitutes in excess of 200,000 sqm. A portion of these premises have already been let; some of them are developed for the companies' own needs, others should attract the interest of local companies in the coming few years, however, according to tentative estimates, at least a half of the planned area might require "external" assistance – i.e. newly coming international companies or expansion of the already established service centres. According to the data of Invest Lithuania, service centres currently operating in Lithuania employ about 11,000 people, implying that the same number of workplaces should be created in order to attain successful implementation of all projects planned in Vilnius and Kaunas. Otherwise, ambitious plans of the developers might become significantly more modest. If the same rapid expansion of the service centres that we have seen to date does not continue and vacancy rates will increase substantially, it is likely that the developers would slow down the development of prospective projects.

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