CBRE Baltics
Part of the CBRE affiliate Network

Riga Offices, Q2 2018

Strong absorption amidst new completions. Rents, yields stable.

Office stock **639,500 sq m**

Vacancy **4.5 %**

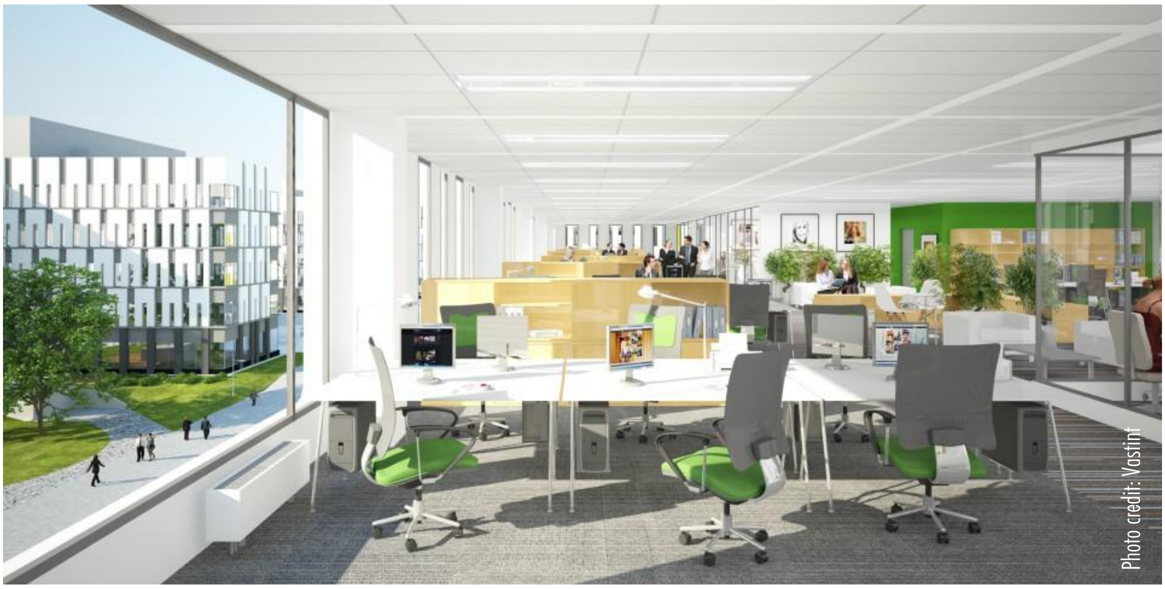
Office Take-up **4,000 sq m**

Completions **20,655 sq m**

Prime yield **6.75%**

*Arrows indicate change from the corresponding quarter in the previous year

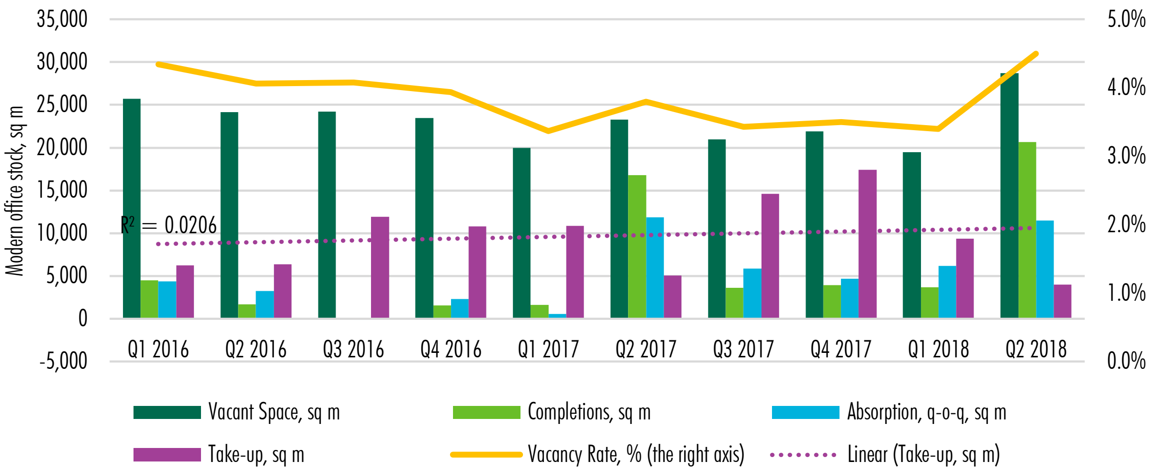
Picture: Business Garden Riga by Vastint



KEY POINTS

- In Q2 2018 the total modern office stock increased by 20,655 sq m to 639,500 or by 3.3% if compared with Q1 2018, which marks one of the largest q/q completions for the past several years.
- The stock was updated with three new office buildings during H1 2018 – Imperial Palace (~ 3800 sq m in Riga CBD during Q1 2018, as well as Salmo Offices (~ 4,300 sq m), a partly owner-occupied project in Imanta and Teodors (~16,300 sq m) in Teika by Hanner during Q2 2018.
- The overall vacancy rate rose y/y from 3.8% in Q2 2017 to 4.5% in Q2 2018 on account of new completions in the B1 class office segment, excluding completions the vacancy rate declined mildly q/q.
- The overall market absorption rate q/q was ~11,500 sq m, in-line y/y. Year-over-year absorption in Q2 2018 amounted to 26,000 sq m, a record high since Q1 2015.
- 61.3% of current modern office stock in Riga consists of buildings built between 2000-2008. In the coming years, a significant part of the current premises will be unable to meet modern standards without renovation.
- Q2 2018 average gross salary in Riga was 1,128 EUR/mth (+7.4% y/y), employment at 64.4% (+1.8% y/y)
- During Q2 2018, take-up activity (excl. renegotiations) marks a new multi-year low of circa 4,000 sq m.
- During H1 2018 the total investment volume in the Latvia office sector was 37.9 mln EUR, showing a decrease of 15.6% when compared with H1 2017, the largest office transaction in H2 2018 was Open Office at Brivibas Street 39 for a reported amount of EUR 6,300,000.
- The leading office investment position during H1 2018 was held by Lithuania (50.1%), followed by Estonia with 29.5%, leaving Latvia in third place with 20.4%.

Figure 1: Main Indicators, Riga Modern Office Stock



Source: CPB Real Estate Services, part of the CBRE Affiliate Network, Q3 2018

SUPPLY

The total modern office stock in Q2 2018 amounted to circa 639,500 sq m. During Q2 2018 there were 2 notable completions in the market. Salmo Offices (~4,300 sq m), a partly owner-occupied project in Imanta and the Teodors building (~16,300 sq m) in Teika by Hanner during Q2 2018.

Currently, the modern office stock in Riga consists of 66% speculative and 34% owner-occupied schemes on a sq m basis. Class A premises are 14% of total modern stock, while B1 and B2 class premises amount to 39% and 47% respectively. Roughly a quarter of all modern premises in terms of sq m area are located within Riga CBD.

61.3% of current stock was delivered to market between years 2000-2008, indicating that a significant part of current premises will need to undergo renovations in coming years to remain competitive or suffer further reclassification and downwards rent pressure as office development heats up, newer projects in all segments will benefit from increased relocation-driven demand.

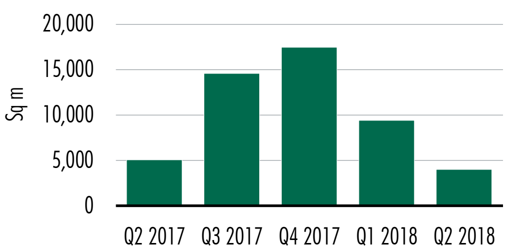
PIPELINE PROJECTS

Currently there is ca. 111,100 sq m of GLA (~17,2% of current supply) under construction or in latter stages of planning (10 developments), of which 26% or ca. 34,700 sq m is represented by renovations /reconstructions. 11,700 sq m is scheduled to be delivered by the end of 2018 on account of Z-Towers (24,000) likely delaying completion until 2019.

The largest project expected to be completed in 2018 is Jeruzalemes 1 (~7,700 sq m) located in Riga CBD, developed by Dyninno Group.

2019 is set to be an important year in terms of office market supply completions, with circa 107,000 sq m of possible additions to the stock, of which Z-Towers and Jaunā Teika Henrihs building amount to 24,000 sq m and 22,000 sq m respectively.

Figure 2: Riga Office Market Take-Up by Quarters



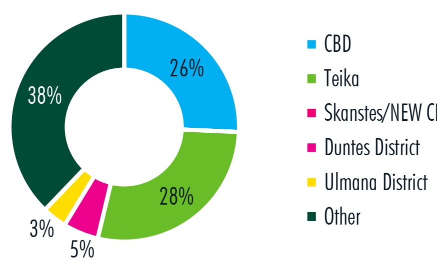
Source: CPB Real Estate Services, part of the CBRE Affiliate Network; Q3 2018

Figure 3: The Latest Indicators for Job Growth, Unemployment and Average Salaries in the Private Sector

Indicator	Q2 2018	Q2 2017
Unemployment Overall (seasonally adjusted)	7.7%	8.9%
Employment rate	64.4%	62.6%
Average Gross Salary in Riga	1,128 EUR/mth	1,045 EUR/mth
Average Gross Salary in Latvia	1,004 EUR/mth	926 EUR/mth

Source: Central Statistical Bureau; Q3 2018

Figure 4: Vacancy by Location, H1 2018



Source: CPB Real Estate Services, part of the CBRE Affiliate Network; Q3 2018

DEMAND & ABSORPTION

The Riga office market has been driven by expansions and relocations. H1 2018 saw considerable leasing activity from IT and finance companies in particular, searching for new offices and expanding existing ones.

The overall market absorption rate q/q was 11,500 sq m, in-line y/y. Year-over-year absorption in Q2 2018 amounted to 26,000 sq m, a record high since Q1 2015 and similar in character to absorption evident during Q2 2017 additions to stock, indicating solid pre-leasing activity and appetite for relocation to newer premises.

During Q2 2018, take-up activity (excl. renegotiations) marks a new multi-year low of circa 4,000 sq m. q/q. Despite below average modern stock performance, a slowdown in leasing activity seems consistent with annual cycles observed during preceding years. Take-up activity is expected to increase in Q3.

VACANCY

The overall vacancy rate rose y/y from 3.8% in Q2 2017 to 4.5% in Q2 2018 on account of new completions in the B1 class office segment, excluding completions the vacancy rate declined mildly q/q. We see an uptake in leasing activity during Q3 2018 and a reduction of overall vacancy.

Class A vacancy rate during Q2 2018 remains at an extremely low level of circa 0.5%, in-line sequentially, amidst lack of class A completions in the market. This situation is not likely to change before 2019.

Class B1 office space vacancy during Q2 2018 has jumped to 6.9% from 3.1% in Q1 2018 following only partly pre-let new completions with significant volume. We expect this new supply to be absorbed quickly.

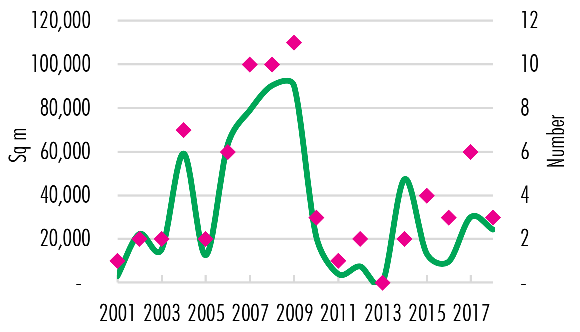
Vacancy has declined from 4.5% in Q1 2018 to 3.7% among B2 class premises, driven by B2 class-heavy leasing activity during Q2 2018. As B2 class stock continues to age in the medium-term, vacancy rates in this market segment is expected to reach beyond 5%, counteracted somewhat by relative average rent decline.

RENT RATES

During Q1 2018, the asking net rent rates ranged between EUR 14-17 sq m/month for class A office space on average, while class B premises were available for EUR 8-14. Rents have remained at a similar level since 2016. In select A class projects rents can reach EUR 18 / sq m/ month. According to a recent CBRE Baltics Riga office market survey: more than 70% of all respondents are currently paying a net rent of up to EUR 12/sq m/month, consistent with stock composition.

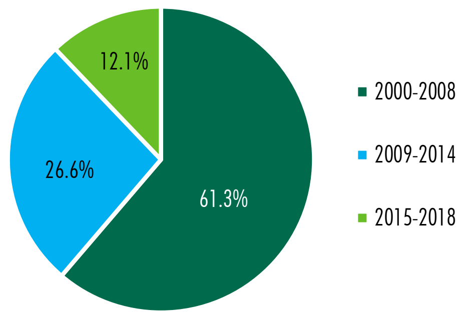
Currently, rents are stable, partly in anticipation of upcoming completions. Current vacancy increases overall are a result of additions to market stock and are unlikely to impact asking rent. The aging B2 class stock is likely to experience supply-side competitive pressure to reduce average rent in light of B2 current and upcoming completions. Quality A class space can be offered in the market at premium in the context of near non-existent supply.

Figure 5: Additions to Modern Office Stock in Riga, sq m



Source: CPB Real Estate Services, part of the CBRE Affiliate Network; Q3 2018

Figure 6: Modern Office Stock, Breakdown by Year of Construction



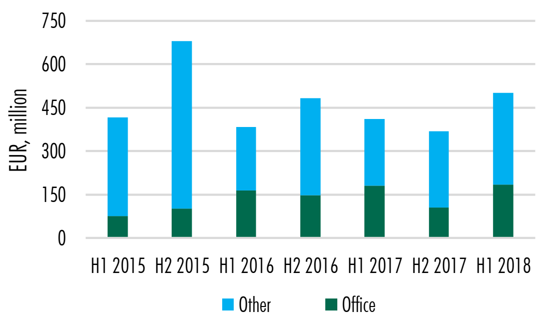
Source: CPB Real Estate Services, part of the CBRE Affiliate Network; Q3 2018

Figure 7: Vacancy Rate

Vacancy Rate	Q2 2018	Q1 2018	Q4 2017
Overall	**4.5%**	**3.1%**	**3.5%**
Class A	0.5%	0.5%	0.0%
Class B1	6.9%	3.1%	3.7%
Class B2	3.7%	4.5%	4.5%

Source: CPB Real Estate Services, part of the CBRE Affiliate Network; Q3 2018

Figure 8: Share of Offices in Total Investment Volume - Baltics



Source: CPB Real Estate Services, part of the CBRE Affiliate Network, Q3 2018

Figure 9: Largest Speculative Office Schemes Currently Under Construction

Origo ONE,
Office GLA ~11,500 sq m

SWH Office Centre,
Total GLA 12,000 sq m

AKROPOLE
Office GLA ~ 9,000 sq m

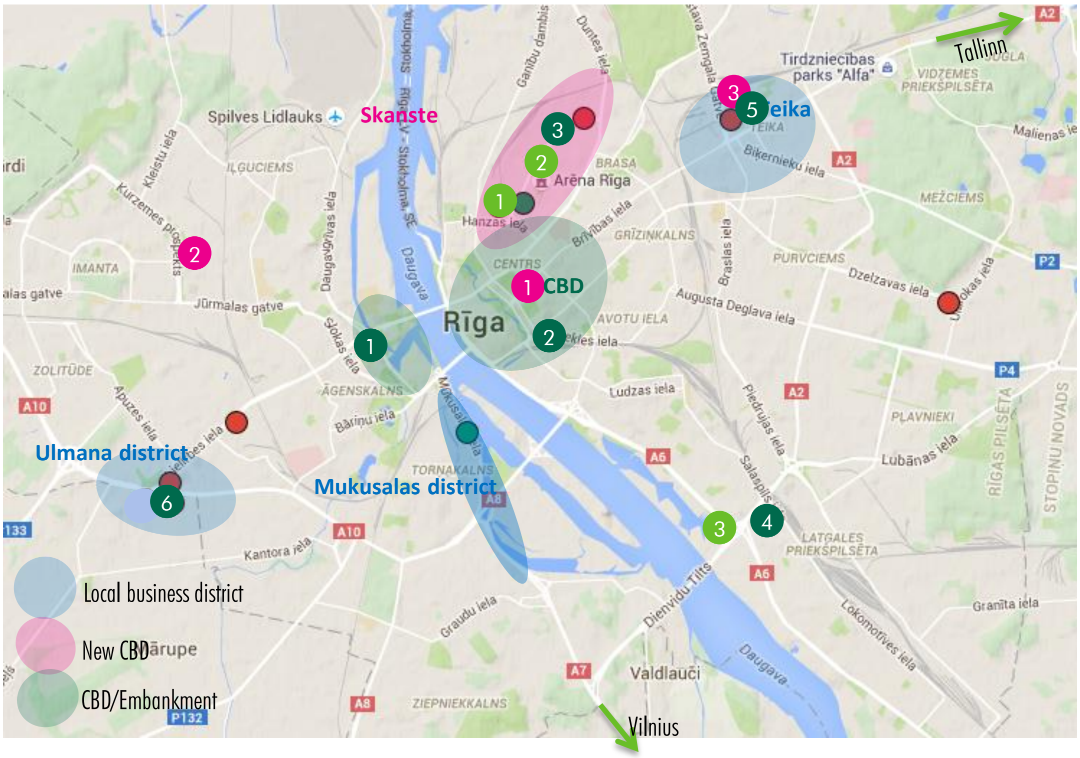
Z-Towers,
Office GLA ~24,000 sq m

Jauna Teika, Henrihs,
Total GLA ~22,000 sq m

BUSINESS GARDEN RIGA, I st. stage
Office GLA ~14,200 sq m

Source: Office Landlords, Q3 2018

Figure 10: Largest Office Schemes Currently under Construction and Largest Planned Projects due to be finished by 2021



Projects completed in H1 2018: (1) Imperial Palace; (2) SALMO biroji; (3) Jaunā Teika Teodors.

Largest Schemes under construction: (1) Z-Towers; (2) Origo ONE; (3) SWH Office Centre; (4) Akropole; (5) Jauna Teika, Henrihs; (6) Business Garden Riga.

Largest Projects in planning stage: (1) New Hanza 1st stage; (2) ELEMENTAL Skanste, 1st stage; (3) Capital City.

Source: CPB Real Estate Services, part of the CBRE Affiliate Network; Q3 2018

DEFINITIONS

Total Modern Stock – represents the total completed class A and B space (occupied or vacant) in the private and public sector at the survey date. Includes owner occupied (OO) space.

Vacancy Rate - represents the percentage ratio of total Vacant Space to Modern Total Stock.

Take-Up – Represents the total net floor space, not including renewals, known to have been let or pre-let, sold or pre-sold to tenants or owner-occupiers during the survey period. A property is deemed to be taken-up only when a binding agreement exists.

Prime Rent – Represents the top open-market tier of rent that could be expected for a unit of standard size (commensurate with demand in each location), of the highest quality and specification and the best location in a market at the survey date. The Prime Rent should reflect the level of which relevant transactions are being completed in the market at the time. If there are no relevant transactions during the survey period, the quoted figure will be more hypothetical, based on an expert opinion of market conditions.

Absorption – represents the change in occupied stock within a market during the survey period.

Net Effective Rent – represents a rent that would be achieved, less the incentives paid by the owner. The average net effective rent for a market is the market net base rent less incentives which are amortised over the term of lease.

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