OBER HAUS
REAL ESTATE ADVISORS

COMMERCIAL REAL ESTATE MARKET COMMENTARY

LITHUANIA / Q3 2017

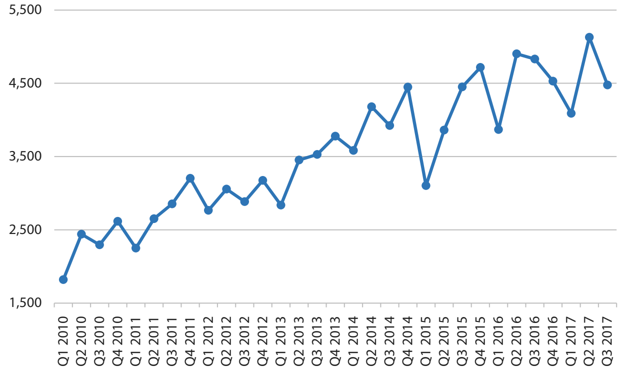
This year's main indicators of the commercial real estate sector show that the market in the country remains highly active. As in previous years, however, two regions – Vilnius and Kaunas – figure primarily on the investors' map. According to Statistics Lithuania, in Q3 2017 nearly **EUR 280 million** was spent on construction works of non-residential buildings in the country or **16% more** than during the same period in 2016 (looking at the first three quarters of both 2016 and 2017 the same growth of 16% in construction works was recorded). In the meantime, the activity of the commercial premises market in the country remained record high. According to the data of the State Enterprise Centre of Registers, during the first three quarters of 2017, a total of 13,696 non-residential buildings and premises were purchased in **Lithuania**. Although compared with the same period in 2016, only a symbolic increase in the number of purchased objects was recorded (0.7%), this is the best result of the first three quarters throughout the history of the country.

Improving financial performance of the companies directly related to the warehousing premises sector, and increasing demand for modern warehousing premises in recent years have determined faster development of this real estate sector. According to Statistics Lithuania, during the first half-year of 2017 revenues of warehousing and storage companies amounted to EUR 71.4 million (excluding VAT) or respectively 15.7% and 18.0% more compared to the same period in 2016 and 2015.

During the first three quarters of 2017, seven warehousing and logistics premises projects were completed **in Vilnius and Kaunas regions**. Four new projects implemented by Ad Rem, Baltic Sea Properties, Arvydo Paslaugos and Woodline were completed in Vilnius region. After the implementation of these projects, the market of the capital city was supplemented with 31,900 sqm of new warehousing premises at the end of Q3 2017 totalling **513,300 sqm** in Vilnius and its environs. Meanwhile, three projects with a combined floor area of roughly 19,000 sqm were completed in Kaunas region. All projects implemented in Kaunas region were intended for own needs of the companies (Vetmarket, Analizė and Aibė). At the end of Q3 2017, the area of modern warehousing premises in Kaunas city and its environs totalled **298,700 sqm**.

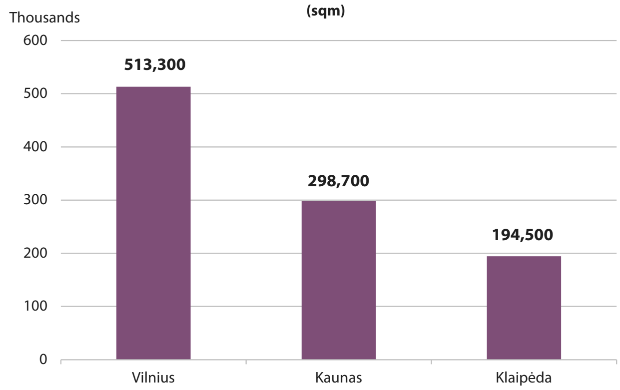
Although in recent years more active development of warehousing premises has been recorded in Vilnius and Kaunas regions, more investment is also planned in Klaipėda region. Like in Kaunas, the projects developed in Klaipėda region are predominantly for own company needs rather than for the market. The SBA Holding plans to start development of its logistics centre and a plant for furniture components near Klaipėda in early 2018. In phase one of the project, a 28,000 sqm central warehouse and a 12,000 sqm plant of the SBA Group is planned to be build. Over the next 10 years, the area of both the logistics centre and manufacturing premises will be gradually increased. The logistics centre will serve both the needs of the SBA Group of companies and other furniture manufacturers. Vakarų Medienos Grupė is planning the construction of a large industrial park in Klaipėda district to accommodate factories and a logistics centre. The company will store and distribute its products through its logistics centre.

NUMBER OF NON-RESIDENTIAL PROPERTY TRANSACTIONS IN LITHUANIA



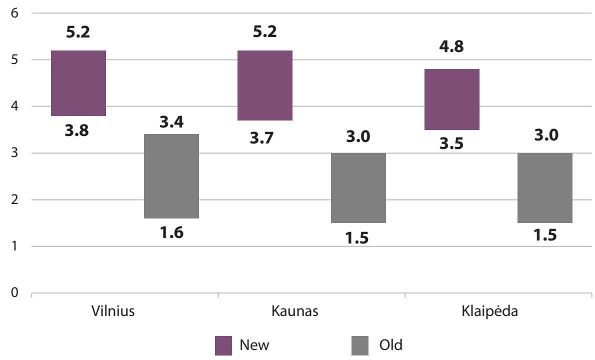
Source: SE Centre of Registers / 2010 - 2017

MODERN WAREHOUSE STOCK
(sqm)



Source: Ober-Haus / Q3 2017

WAREHOUSE RENTS
(EUR/sqm/month, without VAT)



Source: Ober-Haus / Q3 2017

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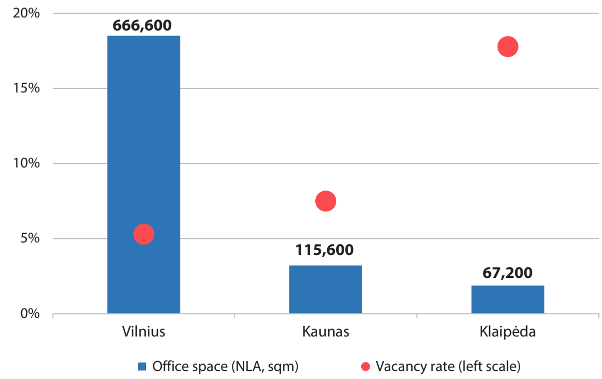
Looking at further development of the warehousing premises sector in Vilnius and Kaunas regions, the number of planned projects and projects in progress is rather large. The companies which plan various projects in these regions aim to expand the sector of new and modern warehousing facilities considerably. By the end of 2017 and in 2018, another 12 projects with a combined floor area of roughly 100,000 sqm are planned in Vilnius and Kaunas regions, of which two thirds of the floor area will be developed in Vilnius region. A total of 30% of the floor area will be projects for own needs of the companies and build-to-suit projects.

High financial performance indicators of the logistics and warehousing premises sector encourage the development of new sites and investment in the renovation of older buildings. Increasing construction costs also contribute to the moderate increase in the rental and sales prices of warehousing premises. During the past 9 months of 2017, the rents of new and old warehousing premises **in Vilnius** region **increased by 3–4%** and in **Kaunas and Klaipėda regions – by 1–2%**. Currently, newly built warehousing premises in **Vilnius** are offered for rent at **3.8–5.2 EUR/sqm** and old warehousing premises at **1.6–3.4 EUR/sqm**. **In Kaunas** new warehouses are offered at **3.7–5.2 EUR/sqm**, old ones – **1.5–3.0 EUR/sqm**, in Klaipėda new warehouses go for **3.5–4.8 EUR/sqm**, old ones – **1.5–3.0 EUR/sqm**.

Q3 2017 was active in the modern offices market. Projects of various sizes contributed to the increase of the modern office space in the major cities of the country. The largest projects were implemented in the capital city, where construction of four new office buildings was actually completed in Q3: Liepyno Verslo Namai, Narbuto 5, Eleven 11 and Green Hall 2. These projects contributed a total of **19,200 sqm** of usable office area to the market in Vilnius which now totals **666,600 sqm**. At the end of Q3 2017, the occupancy rate in these four newly completed buildings was 78% (over 4,200 sqm of the usable office space was vacant). These latest projects did not have a major impact on the overall market indicators and the general vacancy rate over Q3 2017 increased from 5.1% to a mere **5.3%**. The vacancy rate for A class offices was 3.5% and B class – 6.3%.

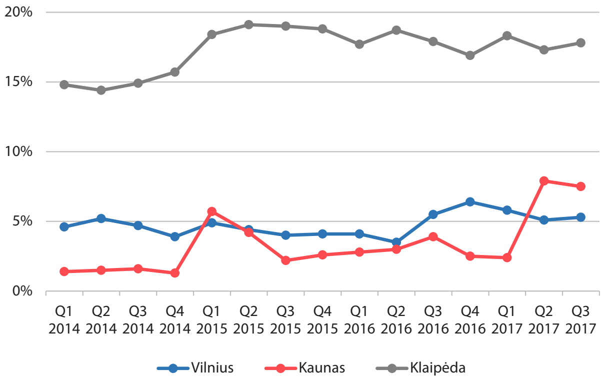
The current office vacancy rate in Vilnius (5.3%) remains fairly stable and exceeds the average of the past ten quarters (4.8%) only by half a percentage point. The business centres that will be completed by the end of 2017 will not make a major difference to the situation in the market, because these buildings have already been leased. In the context of the current development rate of companies, the supply of new office space in 2018 does not appear threatening – the projects scheduled for the coming year will offer nearly 62,000 sqm of usable office space. New projects are attractive to the companies which aim to optimize their physical workspace costs and to attract (or retain) employees by offering them modern, technologically smart and attractive workspace. So the trends are sufficiently clear – in order to compete in today's market, owners of new office buildings must offer an appropriate product and those of older office buildings must upgrade their property.

MODERN OFFICE STOCK AND VACANCY RATE



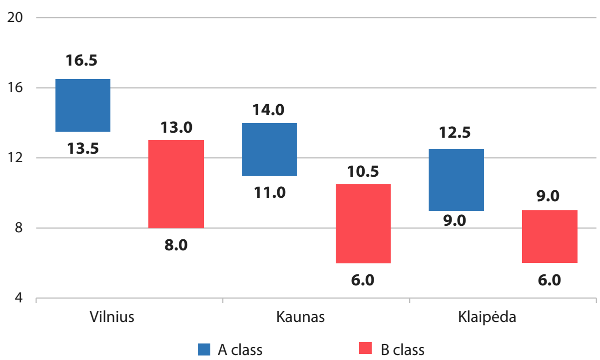
Source: Ober-Haus / Q3 2017

MODERN OFFICE VACANCY RATE



Source: Ober-Haus / 2014 - 2017

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



Source: Ober-Haus / Q3 2017

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Steady and significant increase in supply is useful both for potential tenants and the economic climate in Vilnius in general. Competition between business centres determines that the base rent for office space has not changed substantially since the end of 2015 and currently stands at **8.0–13.0 EUR/sqm** for B class offices and **13.5–16.5 EUR/sqm** for A class offices. However, in order to attract larger and better known tenants, building owners must be much more flexible in the negotiations with the tenants, especially compared to the 2014–2015 period. The medium and larger leasing transactions concluded today for the new and top-class office buildings usually feature rents under 15.0–16.0 EUR/sqm. If the landlord agrees to negotiate on the base rent, the standing practice in the market is that the tenant will pay all additional building maintenance costs (particularly in top-class business centres). That is, the tenants will compensate not only operation and maintenance costs of the building and premises, but also real estate and land taxes, property insurance, and property management costs. Tenants also normally pay a fee for all parking spaces allocated to them.

In anticipation of the completion and opening of lager office building projects in Kaunas, smaller scale projects keep supplementing the market. Two projects were completed in Q3 2017 (Jonava 30 on Jonavos Street and S3 on Studentų Street), which offered **3,800 sqm** of useful office space totalling **115,600 sqm** of modern office space **in Kaunas**. After a sudden increase in the vacancy rate in Q2 2017 (from 2.4% to 7.9%), it stabilised and stood at **7.5%** in Q3. It is likely that due to active implementation of new office projects in Kaunas, the vacancy rate will remain relatively high in the future. It would be too optimistic to expect that the market in Kaunas will be able to absorb the office space offered to the market in a short period of time (even with the help of international companies). However, a sufficiently broad choice of office premises should be seen as the economic growth potential in Kaunas, because workspaces which meet the needs of the market is one of the essential factors for business development. Some office building developers may face competitive challenges – while certain projects will enjoy high occupancy rates and well-known tenants, others may have to be more pro- active in attracting prospective tenants. In all, 11 projects of different scale and for different purpose are planned in Kaunas in 2017. They will offer a total of 35,700 sqm of modern office space. Although the new and top-class business centres slightly increased rents in the city of Kaunas, the price range for modern office premises remains very broad. At the end of Q3 2017, rent for A class offices stood at **11.0–14.0 EUR/sqm** and for B class – **6.0–10.5 EUR/sqm**.

Development of small projects continues to dominate in the modern office market of Klaipėda. In Q3 2017, development of a new 1,000 sqm building was completed on S. Nėries Street. The premises were leased to a dental clinic, a sports and wellness studio and other tenants. Although slowly, businesses are trying to activate the stagnating market by repurposing the existing sites and buildings. For example, Vakarų Laivų Gamykla (Western Shipyard) together with Klaipėda Science and Technology Park founded the Pilies dirbtuvės in an old administrative building on Pilies Street which offers premises to the representatives of creative industries for a small fee. A former industrial site on Liepų Street will accommodate a technology park (Innovation and Business Valley) for educational institutions which train specialists in information technology, digital design and other innovative areas. The site will also accommodate the co-working centre Spiečius to be completed in mid-2018. Meanwhile this year, Stemma Management plans to complete reconstruction of an old administrative building on the former site of Klaipėdos Kranai (Verslo Biurai 103) and offer about 2,500 sqm of retail and office premises to the market. If this project is implemented successfully, by the end of 2017 the modern office space area **in Klaipėda** will total **68,500 sqm** (annual growth rate of almost 4%).

Although at the end of Q3 2017 the vacancy rate of modern office space in Klaipėda was **17.9%**, a large portion of vacant offices are in the buildings constructed earlier (mostly before 2009) (e.g. Business Centre Vitė) and negotiations regarding the property lease in these buildings have not been fruitful for various reasons. So newly developed projects and more flexible approach of the owners to the customer's needs can contribute to a more successful implementation of new projects in Klaipėda than shown by the general market indicators. Office rents remain stable in Klaipėda and currently the rents in B class buildings stand at **6.0–9.0 EUR/sqm**, and in A class buildings – **9.0–12.5 EUR/sqm**.

Saulius Vagonis, Valuation and Market Research Group Manager
Tel.: +370 5 210 97 17, e-mail saulius.vagonis@ober-haus.lt