



Residential apartment market overview

Riga, Latvia

2004 – 2009

IMMOSTATE

Executive summary

Riga socio-economic environment

- The Latvian capital – Riga, is the social and economic centre of the nation.
- The city and the metropolitan area accounts for 43% of the total country population.
- Riga generates the majority of the national GDP, with twice as high GDP per capita as the rest of Latvia.
- The relative accumulation of wealth in Riga is reflected through the highest average salaries of the country.
- Despite increasing unemployment rates (2008 – 2009), Riga remains below National averages suggesting stable employment market.

Riga apartment supply

- Historically Riga apartment supply is well short of the desired demand, as housing fund per capita remains significantly below Western European standards.
- To deal with post World War II migration and population sprawl, the most significant Riga apartment supply growth has been recorded in 1965 – 1995. During the thirty year period approximately 438,000 individuals received apartment housing in the suburban Soviet block buildings.
- Modern apartment deliveries were introduced in 2004, parallel to the Latvian accession to the European Union (EU). Up to Q1 2009, **13,416** modern apartments have been delivered in newly constructed or fully renovated buildings.
- Due to less expensive land acquisition and higher construction intensity the largest proportion - **83%** of modern apartments have been delivered outside the Riga Central Business District (CBD).
- The average project size for suburban (Non-CBD) delivery buildings is **76.4** apartments. Meanwhile each of the CBD projects on average introduces **36.8** apartments.
- Annual modern apartment supply growth has been recorded up to Q4 2007. Whereas, 2008 has shown a **23.6%** supply decline. The negative development trend is expected to continue into 2009 - 2010.

- The construction completion pipeline for 2009 holds 2,827 apartments, 6% less than 2008.
- No credible data reflects development pipeline past 2009, as minimum of 29 projects with nearly 3,000 corresponding apartments have been indefinitely postponed.
- Approximately **4,500 delivered unsold modern apartments** are likely to be vacant at the closure of 2009.

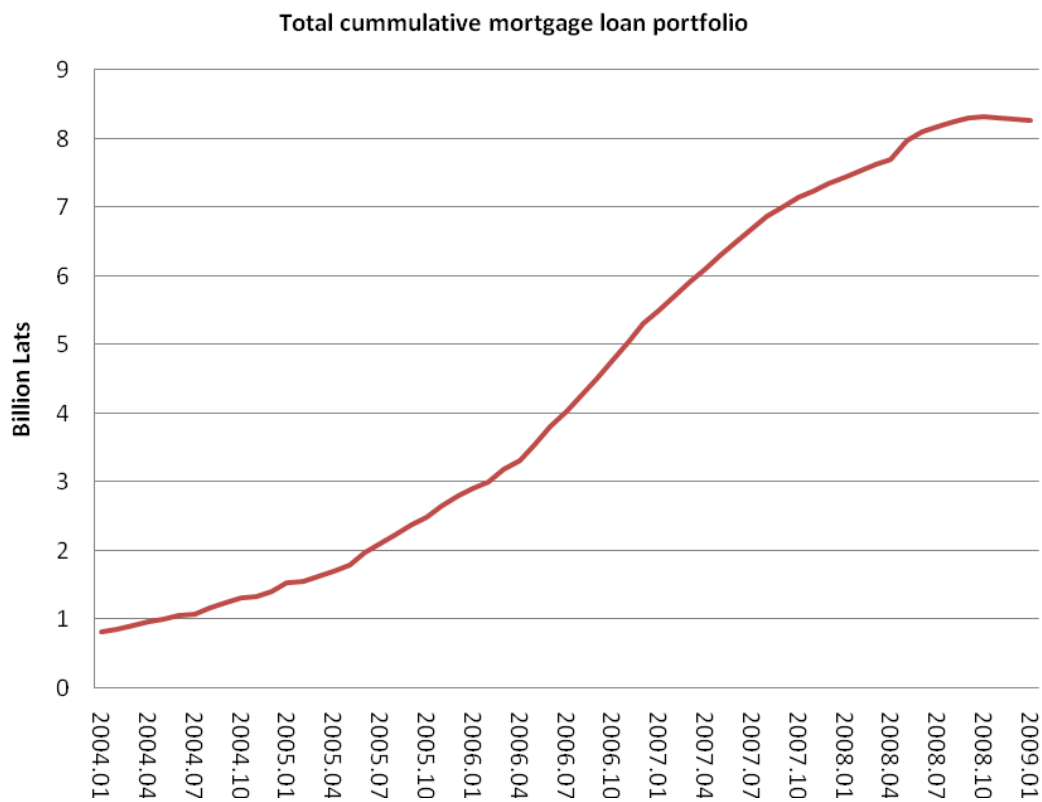
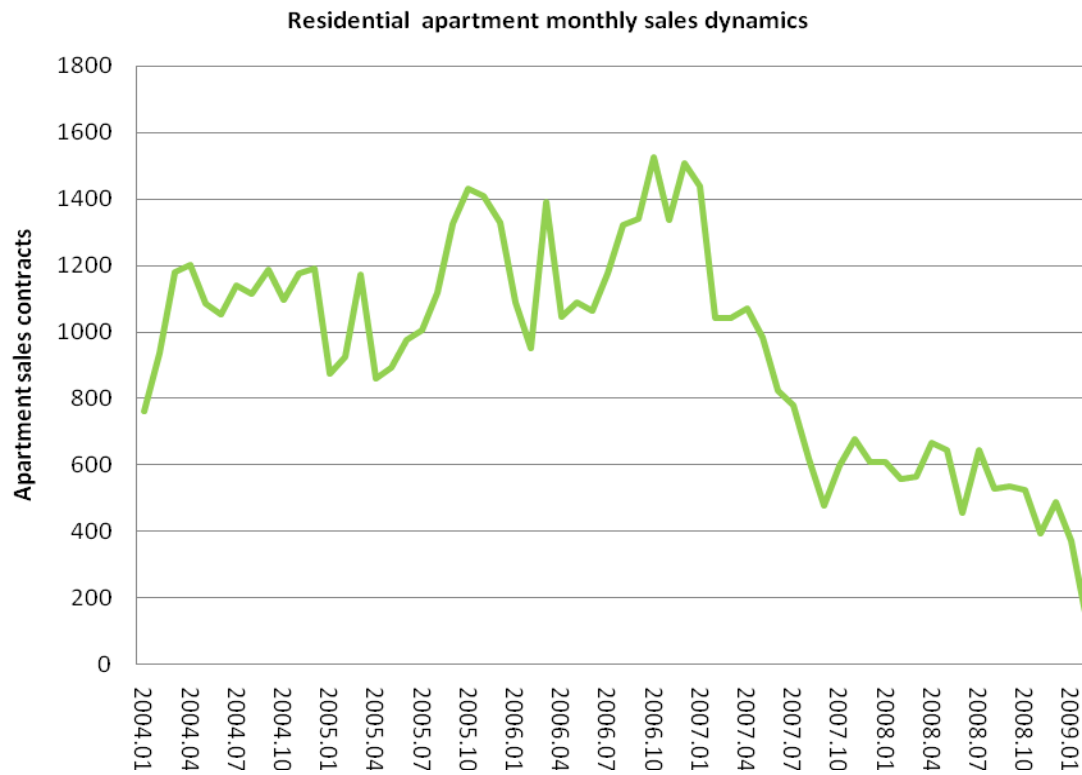
Riga apartment demand

- Overall **10,930 or 81.5%** of 13,416 apartments delivered between Q1 2004 – Q1 2009 have been consumed in the Riga primary market.
- The majority of the total apartment consumption has taken place up to Q4 2007.
- Increasing demand throughout 2004 – 2007, has taken place despite rising apartment prices.
- For CBD apartments the average price has increased up to Q4 2007, reaching the highest average level at **3600 €/m²** - a **140%** price increase since Q1 2004.
- The Non-CBD pricing also reached the highest average at **2300 €/m²** during 2007 with the city record - **187%** price increase since early 2004.
- The demand has shifted following the Latvian government enforcement of stricter regulations for mortgage loan accessibility. A demand decline has continued throughout 2008 despite price drops of **36%** and **47.8%** for CBD and Non-CBD apartments respectively.
- In the following 18 months, due to withstanding personal and financial markets liquidity problems the conventional residential apartment sales activity is likely to remain below 2004 levels.
- More emphasis on **alternative** apartment realization methods are expected to maintain relatively healthy demand.

Riga city in numbers¹



¹ Source: Republic of Latvia, Central Statistical Bureau (CSB), State Employment Agency, Bank of Latvia, State Land Register.
(Exchange rate: 1 Lats (Ls) = 0.70284 EUR)



I. Residential apartment delivery history

In the Post World War II era leading up to the 1995, the development of Riga residential segment was mostly characterized by the construction of city suburban areas in magnitude previously unseen in the Latvian climate.

In the meantime, due to higher density, less vacant land and introduction of historical heritage preservation laws, the structure of Riga CBD has preserved much of its cultural heritage and developed more compactly and on a smaller scale.

Riga Central Business District

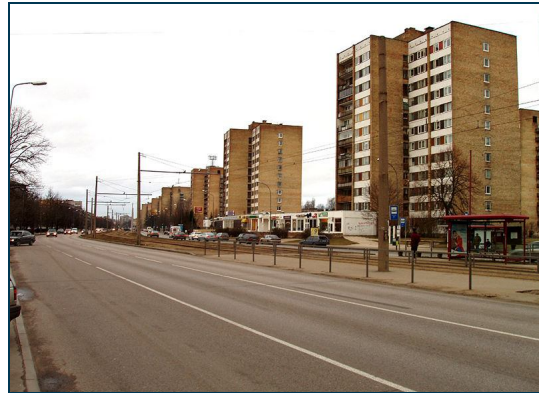


During the massive suburban development sprawl of Riga, entirely new residential districts were delivered in a fashion dominated by Soviet construction method block housing.

The most intense construction time period has been the 20 year span from 1965 to 1985, during which *Jugla*, *Kengarags*, *Imanta*, *Purvciems*, *Bolderaja*, *Ilguciems*, *Vecmilgravis* and *Mezciems* districts have been delivered altogether providing housing for approximately **331,000** residents.²

The 1985 – 1995 span is considerably the final wave of Riga suburban block housing construction, during which the residential districts of *Plavnieki*, *Zolitude* and *Ziepniekkalns* have been constructed providing additional housing for approximately **107,000** residents.

Kengarags



Plavnieki



Notably, within the 30 years (1965 – 1995) the suburban areas of Riga added housing for approximately **438,000** residents or nearly half of the total population of the city at the given time. Such new housing opportunities were much appreciated by the typical three generation families living under one roof prior to that.

Due to the satisfied housing shortage and no incentives or practice for modernized developments, the time period from 1995 up to the EU accession in 2004, has been considerably the “Silent period” of residential development in Riga.

² Source: Wikipedia on-line encyclopedia:
http://lv.wikipedia.org/wiki/Daudzst%C4%81vu_dz%C4%ABv_ojamie_rajoni_R%C4%ABg%C4%81

II. Modern apartment deliveries

In 2004, thirteen years after regaining independence, the Latvian economy had achieved significant growth and a European Union (EU) accession. The expectations and opportunities for average households were beginning to surpass the block-housing of suburbs or worn-down CBD historical buildings.

In order to follow the increasing demand for high standard Western European-like residential housing, the launch of the latest residential development wave was given.

In the following five years the Latvian residential apartment market resulted in one of the fastest growing property markets in the EU.

Delivered modern residential stock (Q1 2004 – Q1 2009)

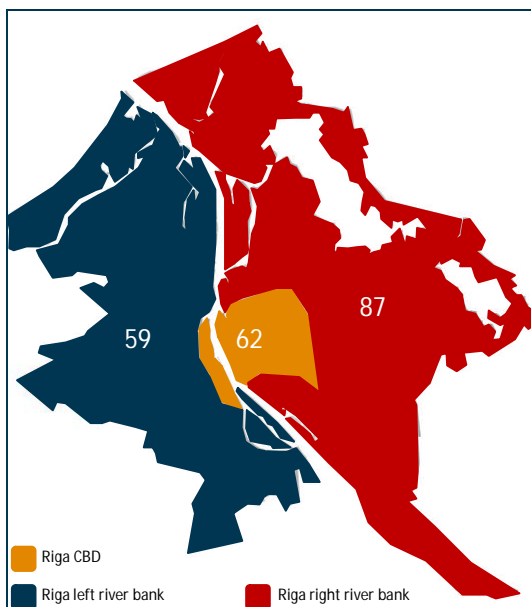
According to Immostate residential market survey (further – survey),³ as of February 2009, **208** modern residential developments (further – projects)⁴ have been delivered, with corresponding **13,416** apartment units. The survey is limited to Riga city limits and excludes metropolitan area.

Some of the largest deliveries include: *MezaCiems* – 475 units (*Mezciems* district – right river bank), *Metropolia (I-III stage)* – 330 units (*Imanta* district – left river bank), *Purvciema Projekts* – 322 units (*Purvciems* district – right river bank), *Solaris* – 320 units (*Imanta* district – left river bank), *Panorama Plaza (I-II stage)* – 300 units (left river bank), *Dienvidu Pakavs (I-II stage)* – 295 units (*Ziepniekkalns* district – left river bank) and others.

Due to the specifics of Riga, the most active development has taken place on the right bank of river Daugava.

The CBD has delivered **62** projects, the rest of the Riga right river bank – **87** residential projects. Meanwhile, the left bank of river Daugava accounts for **59** modern residential project deliveries.

Total modern residential project deliveries by area



The delivered project magnitude has been significantly influenced by the city zoning regulations and land plot availability.

Due to the Riga CBD preservation guidelines, the central part of Riga allows one of the lowest construction intensity alongside some of the highest land acquisition costs.

In contrast, the suburban districts of Riga on both sides of river Daugava, introduce large vacant plot offer with more reasonable pricing and higher construction intensity allowances.

Despite significant number (62) of delivered projects, CBD holds only 2,282 delivered apartments with **average project size (APS)**⁵ of **36.8 units**.

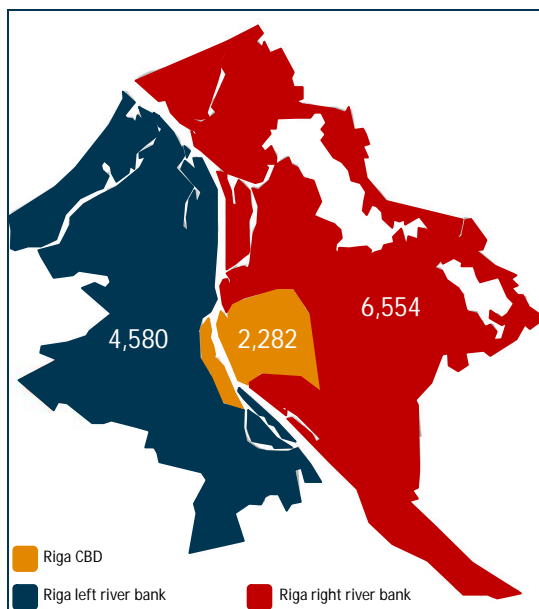
In comparison, the outer city areas on both sides of the river hold 4,580 apartments on the left river bank (APS – **77.6 units**) and 6,554 apartments on the right river bank (APS – **75.3 units**).

³ Source: Immostate data verification internet and telephone based Real estate developer survey, conducted from 1.12.2008.-31.1.2009.

⁴ Multi-unit (no less than 6 apartments) new construction or complete building renovation or a mix of new construction and renovation schemes.

⁵ Total number of delivered units divided by number of delivered projects in a given area.

Total modern residential apartment deliveries by area



An average of **90.8** residential units per annum were delivered in the “Silent period” between the closure of massive Soviet block housing development in 1995 and launch of the described modern residential developments in 2004, providing just enough time for new demand growth.⁶

Although quantitatively Q1 2004 – Q1 2009 residential apartment supply is short of 1965 – 1995 Soviet block housing production, qualitatively the modern developments of Riga have established a turning point in residential apartment standards and are considerably more demanded.

The total **13,416** modern residential apartment deliveries per year are summarized in the table below:

2004	2005	2006	2007	2008
1,297	1,566	3,596	3,944	3,013

Year 2009 delivery pipeline

Based on survey data and project site visits, there are estimated **21** residential project deliveries with corresponding **2,827** apartments set for year 2009.

Although still a significant supply, 2009 deliveries are due to experience **28.3%** supply decrease from the record of 2007, and **6.2%** estimated decrease from the supply of 2008.

Only **290** estimated unit deliveries are in the pipeline for the CBD district of Riga, meanwhile **1,567** units are due on the right river bank suburban areas and **970** units on the left.

The largest outside CBD deliveries for 2009 include, *Dzimta Seta IX* - 518 units (*Mezciems* district – right river bank), *Skanstes Virsotnes (I-III)* – 391 units (*Skanste* district – right river bank), *Kengaraga Zieds* – 290 units (*Kengarags* district – right river bank).

Meanwhile, some of the most notable CBD deliveries for 2009 include: *Olive* – 48 units, *Alauksta street 9* – 41 units, *Petit Paris* – 30 units.

Residential project - Skanstes Virsotnes (I-III)



Residential project – Olive



⁶ Source: CSB „Total number of apartments built in Latvian cities and regions”.

Postponed modern apartment deliveries

The 2004 EU accession with associated income and bank issued mortgage portfolio growth accompanied with share desire for modern living standards suggested high demand for modern residential apartments in Riga.

In order to satisfy the increasing demand for modern residences, the developers responded by providing on average **172%** more apartment deliveries in 2008 as were available in 2004. Such production on behalf of developers was generously rewarded all throughout 2004 – 2007, with estimated **92.2%** consumption of all deliveries in the period.⁷

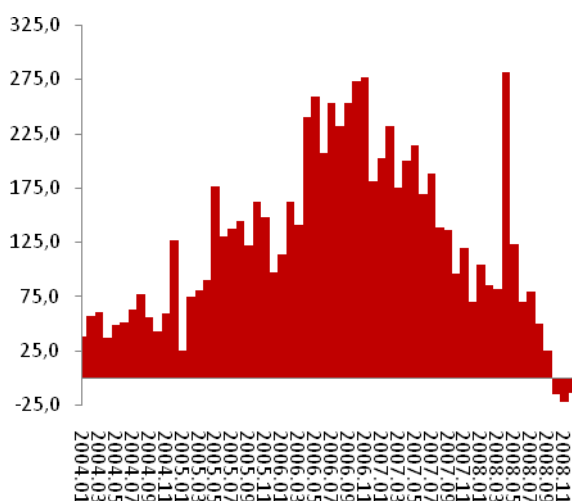
As a part of international advisory and Latvian government plan addressing the overheating of Latvian economy in Q2 2007 an “Anti-Inflation Plan” (further – Plan) was passed, in sections setting out much stricter regulations for private entity mortgage loan accessibility.

Generally, the Plan introduced two previously unexercised matters for mortgage loan obtainment: (a) mandatory State Revenue Service income statement; (b) mandatory minimum 10% down-payment for any acquirable property (overturned in Q1 2008, but maximum mortgage value remains at 90% or less of the property value). Given a significant grey economy scale and shortage of private savings significant majority of the demand no longer qualified for mortgage loans.

Although up to Q1 2009 an overall growth in issued mortgage loan portfolio has been recorded, since Q3 2006 the Bank portfolio growth has taken place at a **decreasing rate**. For instance, between Q4 2004 and Q5 2005 the bank mortgage portfolio has more than doubled (101.6%) with an increase of 1.41 billion. Same period 2005 – 2006 portfolio increased by 89.2% or 2.5 billion, but despite significant growth showing decreasing rate. Following the same path, despite total portfolio growth in 2007 and 2008, the mortgage portfolio increase is recorded at a much lower rate: 38.5% and 12.6% respectively.

First time declining mortgage loan growth has been recorded in November, 2008 with 15.9 million Lats mortgage portfolio decrease. The decreasing trend continues into Q1 2009.

Bank mortgage loan portfolio monthly dynamics (million Lats)⁸



The decreasing lending activity has had a significant impact on the residential developers. Since the introduction of the Plan, the overall market activity has declined. With it increased bank concerns regarding development financing for on-going or new developments in a saturated residential market. As a result, 2008 – 2009 has led many residential real estate entrepreneurs to indefinitely postpone the launch of their projects or to suspend the on-going construction.

According to survey data, as of February 2009, there are a minimum of **29** residential projects with no less than **2,866** units postponed during various stages of development with no announcements for continuation.

Residential project and unit delivery summary

	Projects	Apartments
Delivery (Q1 2004 – Q1 2009)	208	13,416
Delivery (2009)	21	2,780
Indefinitely postponed	29	2,866
Total:	258	19,062

⁷ Residential unit sales and pre-sales in the primary market (developer to client) does not exclude speculative deals.

⁸ Source: Bank of Latvia

III. Modern apartment consumption and price dynamics

Delivered residential stock consumption (Q1 2004 – Q1 2009)

According to survey data, as of February 2009, **81.5%** of all Q1 2004 – Q1 2009 delivered residential units have been consumed in the Riga primary residential market. Most of it, however, accounted for the realization between 2004 – 2007.

Delivered/consumed apartment breakdown per Year

	Delivered apartments	Consumed apartments ⁹	%
2004	1,297	1,297	100%
2005	1,566	1,529	97.6%
2006	3,596	3,459	96.2%
2007	3,944	2,923	75.1%
2008	3,013	1,682	55.8%
Total	13,416	10,930	81.5%
Unsold built stock:		<u>2,486</u>	

As of February 2009, there are no unsold apartments from 2004 delivery.

Only 37 and 137 units still remain unsold from the 2005 and 2006 supply, meanwhile 981 apartments remaining on the market from 2007, suggesting unsold accumulation from 2004 - 2007 at 1,155 apartments.

Year 2008 alone has contributed additional 1,331 units to the unsold stock, summing up to a total modern **residential apartments unsold stock of 2,486**.

⁹ The consumption from pre-sales during the construction period or sales after delivery, does not exclude speculative purchases.

Delivered residential stock price dynamics (Q1 2004 – Q1 2009)

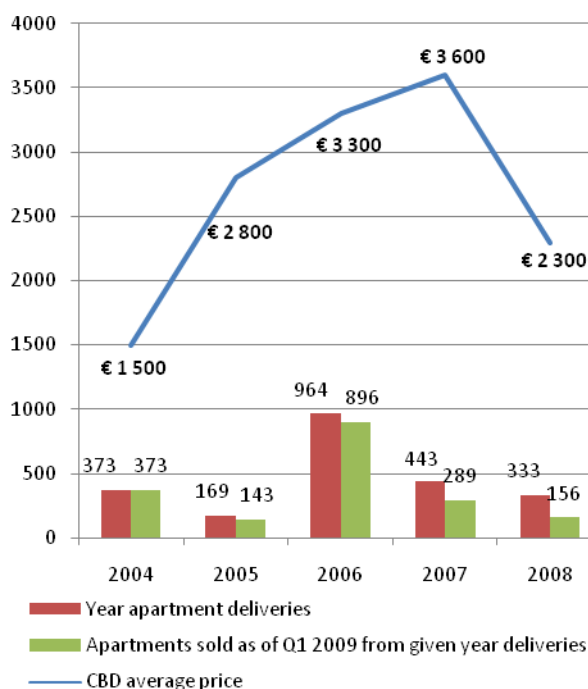
The following sub-section outlines the observed price dynamics for the delivered modern residential apartments in Riga CBD and both of the river-banks outside CBD area (Non-CBD).

CBD

For CBD apartments the average price has increased up to Q4 2007, reaching the highest average level at **3600 €/m²** - a record **140%** price increase since Q1 2004.

On the other hand, after record highs a year before, 2008 has delivered a sharp **36%** CBD residential unit price decrease.

Graph 1 – CBD apartment consumption/price breakdown by Year¹⁰



Although no available data reflects the exact timing of CBD residential unit purchases, it is established from market experience, that in the modern residential supply shortage period of 2004 – 2006, residential units were mostly acquired before delivery via reservation or pre-sale agreements. Hence, establishing high market activity and low unsold unit accumulation despite increasing prices.

¹⁰ Source: Business Analytics „New Projects“; Immostate survey data. Price averages for new residential project development unit per square meter as of Q4 for each of the given years.

Year 2007 introduced a turning point for positive CBD apartment price/demand correlation. With growing delivered and unsold supply of residential units the benefits of pre-sale agreements were no longer as relevant. In addition, buyer preferences began to shift toward completely finished, quality assured units as more careful selection was necessary due to the price peak. As of Q1 2009, approximately 35% of 2007 deliveries still remain unsold.

Unfortunately, the recorded price drop of 2008 has not been able to lift the market activity for CBD residential units leading to a significant - 53% unsold apartments from 2008 delivery stock.

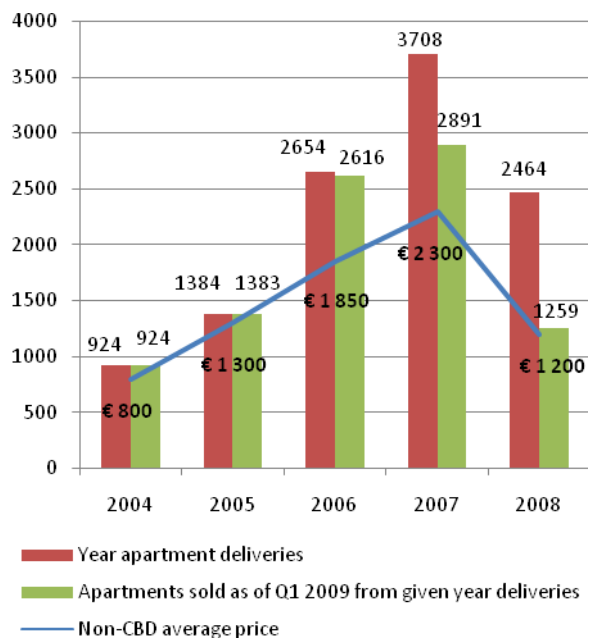
At the closure of the 5 year span, approximately 20% of all delivered CBD units remain unsold in the primary market. The majority of which accumulated since 2007.

Non-CBD

The Non-CBD pricing also reached the highest average at **2300 €/m²** during 2007. Although the pricing of Non-CBD deliveries remained below the CBD, the outer city centre area projects in 2007 introduced the highest pricing growth since 2004 at **187%**.

In turn, the Non-CBD average **47.8%** price drop from 2007 to 2008 indicates the largest decrease of all modern apartment deliveries in Riga.

Graph 2 – Non-CBD unit sales/price breakdown per Year



A similar pattern, but quantitatively much larger market activity has been observed for the Non-CBD apartment units. Up to 2006, nearly all available residential apartments in Non-CBD areas were acquired before or during the year of delivery leading to nearly non-existent accumulation of unsold stock.

As for CBD counterparts, the Non-CBD sales profit maximizing trends were reversed in 2007 and continued to worsen throughout 2008 despite the largest price decrease in the Riga modern apartment market.

As of Q1 2009, larger quantity, but similar proportion - 20% of Non-CBD delivered units remain unsold in the primary market, most of vacancies likewise delivered in 2007 and 2008.

IV. Forecasts

- With low personal liquidity levels and lack of trust from the banks private entity residential apartment sale activities are likely to remain below 2004 level all throughout 2009 – 2010.
- Due to still significant unsatisfied demand for modern apartment living space, the low affordability levels of private entities are likely to force the real estate developers into alternative realization methods. Although most often subject to a mutual agreement between project financier (bank) and developer, as an alternative to an immediate premise acquisition, is suggested apartment **rent with first hand buy-up rights**.
- The rent with buy-up is likely to begin to dominate the 2009 - 2010 apartment residential market in Riga. Under the conditions of rent with buy-up, client is offered an opportunity to bypass bank mortgage for a fixed 2-3 year period, during which 80 - 100% accumulated rent payments are allocated toward sale price after rent period expiration.
- Although traditional acquisition methods will remain in the 2009 - 2010 Riga residential apartment market, it will contribute to a smaller proportion of the residential market activities.
- Further pricing downward correction is expected throughout 2009, only to be stabilized after signs of economic recovery and lending activity.
- The CBD apartment price lowest margin is likely to be reached in Q3 2009 at average of **1,700 €/m²**. Selective elite CBD property levels will remain slightly higher at estimated **2,200 €/m²**.
- Non-CBD unit prices are likely to experience the largest overall decline reaching the lowest point at **650 – 700 €/m²** also in Q3 2009.
- During the 2009 – 2010 a higher demand is expected for CBD and other prime location apartments with historically higher “value for price”.
- Subject to legislative policies as an alternative source of demand for accumulated residential stock may become **municipality**. Rapidly declining apartment pricing, especially in Non-CBD areas, is approaching acceptable price levels of municipal social housing acquisition. It is estimated, that as many as **10,000 families** are currently awaiting social housing from Riga municipality¹¹. Parallel to social housing construction portions of the delivered, price and area suitable stock may be acquired by the municipality for social housing.
- During 2008 approximately 30% less building permits have been issued in comparison to a year before¹². The downward trend is likely to continue well into 2009, as debt and equity financing for residential developments will remain scarce.
- Granted completion of 2009 deliveries, it is estimated, that the total accumulation of delivered unsold modern apartment supply will be approximately **4,500 apartments** at the **closure 2009**.
- Currently postponed projects are highly unlikely to resume development activity in 2009, due to persistent financing constraints.
- Granted stabilization of apartment market activity and revival of financing availability, the earliest notable resume of residential development activity in Riga is **Q3 – Q4 2010**.
- During the resurgence of residential market, the first movers are likely to become projects postponed during construction. Only to be followed by previously unannounced or redesigned residential schemes.
- The residential development gap of 2009 - 2010 will allow for **increased** consumption of already delivered stock leading to a decline of unsold vacancies.

¹¹ Source: Riga municipal housing data.

¹² Source: CSB

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