

Riga office centre overview

Latvia

2009

IMMOSTATE

Economy

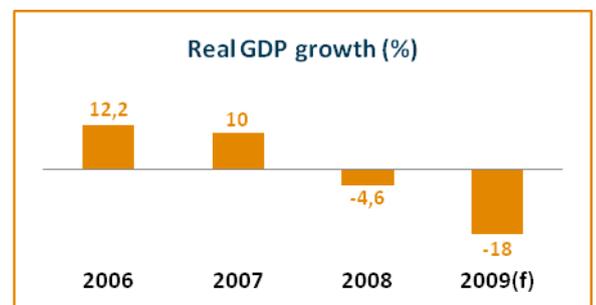
2009 economic situation in Latvia is best summarized in a recent *Economist* online article – “Like many small countries, Latvia has struggled to attract outsiders’ attention. Now it is famous, and hating it”.

The current macroeconomic figures of Latvia indeed are nothing to be proud of, as the burst of the credit bubble has hit the Baltic nation hard.

Latest Latvian GDP numbers predict output shrinkage of roughly one fifth – 18%, alongside soaring unemployment rate set to exceed 16% at the closure of 2009 nationally and slightly lower rates in the capital Riga (12%). Similarly, the positive net wage growth achieved in the growing economy years is sharply decreasing and taking the entire retail industry with it, as reflected by 30% retail turnover collapse.

The economic turmoil has forced Latvian government to turn to the international donors for financial aid and undertake massive fiscal changes in government spending and taxes.

It may well be true that there is no easy solution to Latvia’s current economic problems. Nonetheless under strict surveillance of the international community including the European Commission and the International Monetary Fund the country is gradually stabilizing, reflected by early signs of major economic downturn halt.



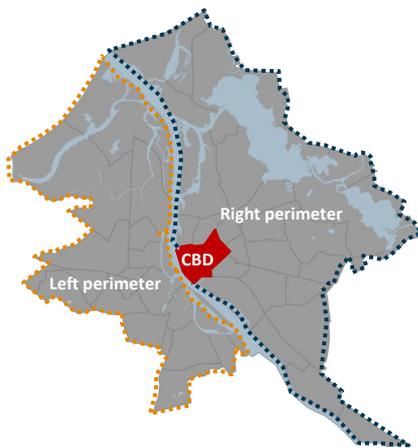
Central Statistical Bureau, State Employment Agency data

Demographics & Employment

Riga city covers 260 square kilometers ground area and is home to 716,000 inhabitants.¹ Geographically, the city is divided by river *Daugava*, which is the most significant predetermining aspect of Riga's infrastructure, commuting and business locations.

Despite covering less than 2% of the total ground area, business focal point of Riga remains Central Business District (further - CBD) with as many as 23% of workplaces provided.² Riga Right perimeter covers the largest – 60% of the city's ground area and provides workplaces for half of the employed persons, but Left perimeter covers 38% of land and is permanent workplace for the remaining 27% of the city's workforce according to the public Municipal data.

Riga zone division



The Central Statistical Bureau (CSB) 2009 third quarter (Q3) data has recorded 953,900 employed individuals in Latvia, near 16% decrease since the same period a year ago. Almost 91% of individuals in Latvia are employed on a full time basis, the rest - 9% part-time, according to the CSB figures.

Historically, Riga has employed roughly 40% of the country's workforce. The trend remains similar for 2009, as estimated 378,700 full and part-time individuals are employed in the capital city.³

Riga Municipal data shows construction, industrial and logistics sector employing 32% of active workforce, retail and distribution trade adding 22%, meanwhile public sector health care, educational system and state administration employing approximately 19% of Riga labor force.

Common office centre occupiers – commercial and financial trading organizations employ estimated 17% of city's workers. Finally, other smaller scale industries contribute to the remaining 10% of workplaces.

Office supply

At the end of the reviewed period Riga "A" and "B" class multi tenant office centre **Gross Leasable area (GLA) has reached 345,500 sqm total supply**. Additional 113,500 sqm office centre leasable area constitutes Riga's built-to-suit stock, which is self-sustainable in the market context.

Following the impressive multi tenant office centre supply growth in years 2007 and 2008 with 70,400 sqm and 94,360 sqm of GLA delivered, respectively, the analyzed period has been a different story.

Withstanding economic downturn and weak demand outlooks have eliminated or significantly lowered many of the office development ambitions. As a result, 47,000 sqm office centre GLA completed during 2009 is notable 30-50% below preceding years construction output.

Nearly half (48%) of Riga's office centre supply is located on the Right perimeter. Estimated 24% of the supply is concentrated in the CBD, while 28% office centre leasable area is located across the river on the Left perimeter of Riga.

2009 has brought no significant changes to the class makeup of the office supply. "A" class multi tenant office centers still remain scarce and constitute just below 9% of the total supply.

The vast majority of the office supply is positioned in the "B" class. Hence, "B1" office centers with combined 177,500 sqm GLA (51% of the total supply) are the single largest office centre class in Riga, followed by "B2" class with 137,500 sqm GLA and 40% of the total supply.

Europa business centre – 2009 largest multi tenant office building delivery (15,400 sqm GLA)



According to the numbers Riga office centre supply has grown rather significantly. In practice, however, as much as 25% of new supply is in pre "move-in" condition, thus adding to the downward pressure on new supply take-up.

This a result of growing economy development strategies, where many developers had selected bringing up office buildings to pre "move-in" condition and planned to customize offices after signed covenant at 2007-2008 lease rates.

Today, however, with diminishing financing and low returns on collapsed lease rates, majority of developers are no

¹ CSB data for city limits, greater metropolitan area including the city circa 1.1 million inhabitants.

² Riga Municipal data.

³ Immostate analysis based on Riga Municipal data.

longer capable of executing their initial strategies, hence, keeping potential tenants waiting. Especially as cash short occupiers are also hesitant to invest in premise accommodation, and expect the premises in suitable condition.

Important changes in supply have also taken place in the non-core office market of Riga CBD. Aside from specialized office centers, Central Riga holds a notable concentration of office premises in sections of historical residential buildings.

Up to 2009 the so-called individual office supply was self-sustainable and represented very low vacancies with long term covenants and reputable occupiers in form of bank offices and governmental organizations. In the reviewed period, however, previously stable individual office sub-market has become fragile.

As a part of national budget cuts, many government organization tenants have been forced to vacate or significantly downsize customized and convenient Riga CBD individual office locations, leaving approximately 5,000 – 7,000 sqm of vacant supply.

Similarly, with two of the major banks – *Parex Bank* and *Nordea* concluding their respective built-to-suit headquarters construction, as much as additional 15,000 – 17,000 sqm of bank occupied space around Riga CBD is released back to the market.

Parex Bank headquarters – 2009 largest built-to-suit office building delivery (20,000 sqm total area)



Office demand

In terms of office demand and take-up, year 2009 has brought a few surprises, certainly a very few positive ones.

As expected, worsening economic environment has left severe impact on businesses across all sectors and sizes. Hence, alongside staff and administrative cost optimization, entrepreneurs are reconsidering leased or prospective lease area parameters and costs.

To make matters worse, despite new office development slowdown in 2009, total multi tenant office centre supply has increased to 345,500 sqm well in front of potential demand.

As a result of country's macroeconomic problems and significant office supply **29% office centre vacancy rate or 102,000 sqm GLA vacant supply has been recorded** at the closure of 2009.

The highest city office centre vacancy rates are recorded outside CBD, with 33% (32,000 sqm) of supply recorded vacant on Riga Left perimeter and 29% (49,000 sqm) on the Right. Riga CBD reflects relatively lower multi tenant office centre vacancy rate of 26% (21,000 sqm).

2009 Riga multi tenant office centre supply/vacancy summary

	Q4 2009	Q4 2009
	Total supply	Vacant supply
"A" and "B" class multi tenant office centers	345,500 sqm	102,000 sqm

Period has clearly shifted market power to the hands of tenants. Provided low office centre occupancy (71% or 243,500 sqm), tenants are much more careful in premise selection and reserve significant bargaining power regarding lease conditions and price.

In all city zones most demanded remain completed offices in size 100 sqm or less. Larger offices were occupied at much slower pace, mainly due to tenant solvency and overall downsizing trend of 2009.

Contrary of office tenant migration outside of Riga CBD during price growth of previous periods, in 2009 with greater space availability, but more importantly - affordability, tenants are shifting focus back to Central Riga.

The overall demand shows more popularity for established office centre schemes, with relatively higher occupancy rates.

Market newcomers with low occupancy rates and pre "move-in" condition office premises are in the most challenging position due to incapability or unwillingness to invest in premise customization for potential tenants.

Office lease levels

The only mutual office market trend since the end of 2008 has been the overall lease price drop. All other market activities in 2009 have taken place on individual basis.

After a sharp nose dive early in 2009 lease price decline steadily slowed down, but still resulted in massive **40% asking lease price decline** across all city zones and office center classes. Furthermore, reviewed period introduced more “real” lease price downward correction due to significant tenant negotiation power.

On average, 2009 lease deals have been signed at as much as additional 20% below asking lease price levels for “A” and “B1” class offices, but just around asking level for “B2” class offices.

Riga CBD presents the largest variety of office class makeup and relatively larger popularity. This, however, has not prevented Central Riga from an overall 35% asking lease price declines at the end of 2009 in comparison to the same period a year ago.

2009 Riga CBD lease price summary

	Q4 2008 asking lease price	Q4 2009 asking lease price	2009 average signing lease price
“A” class	16-18 €/sqm	12-14 €/sqm	10-12 €/sqm
“B1” class	12-14 €/sqm	7-9 €/sqm	5-7 €/sqm
“B2” class	10-12 €/sqm	5-6 €/sqm	5-6 €/sqm
Individual offices	10-12 €/sqm	6-8 €/sqm	4-6 €/sqm

Riga Right and Left perimeters as the largest holders of city’s office centre GLA supply have likewise experienced the most significant asking lease price drops at 40% and 45%, respectively. Hence, the city perimeter also seems most challenged for recovery in the near future.

Riga Right perimeter lease price summary

	Q4 2008 asking lease price	Q4 2009 asking lease price	2009 average signing lease price
“B1” class	11-13 €/sqm	6-8 €/sqm	4-6 €/sqm
“B2” class	9-11 €/sqm	4-5 €/sqm	4-5 €/sqm

Riga Left perimeter lease price summary

	Q4 2008 asking lease price	Q4 2009 asking lease price	2009 average signing lease price
“B1” class	12-14 €/sqm	6-8 €/sqm	4-6 €/sqm
“B2” class	10-12 €/sqm	4-5 €/sqm	3-5 €/sqm

Forecasts

- Office market climate will remain closely tied with the economic health of the country.
- The relative slowing of Latvian economy freefall has come at a very high cost. In 2010, the country will be facing one of the leanest budgets since EU accession. Businesses and individuals will be introduced to new and increased taxation policies, leaving already cash-shorthanded entities in much tougher position.
- Despite general caution and challenging entry position small and medium size businesses will gradually re-enter the market in 2010.
- As a result of returning activity, Riga office centre vacancy rate is likely to decrease, however, will still remain significant at circa 15% by the end of 2010.
- Due to no major office schemes in the pipeline for 2010, the office centre supply is set to remain flat at 2009 output level.
- 2010 office centre asking lease prices are likely to merge with 2009 signing level and remain stable at such rate. This shall provide small comfort and relatively foreseeable conditions for the office centre owners and developers.
- Although stabilizing in the longer term, Riga office centre market will remain saturated for any new mid-term (2010-2011) office development schemes, as they may lead to even greater office centre GLA surplus.
- Immostate estimated 60,000 (15%-16% of active workforce) employed person’s at Riga office centers in 2009, suggest average office centre GLA take-up of 5,9 sqm per person. In 2010 per person take-up is likely to stay the same or even slightly decrease as tenants will continue to sacrifice comfort for greater business stability.
- In the long-term perspective, provided resumed economic stability, achieved sustainable growth and regained international appeal, Riga presents selective office centre market growth opportunities due to:
 - A. Low office centre supply growth in 2010-2011 and resulting current surplus take-up (vacancy rate decline);
 - B. Strengthening and market return of office centre tenant core - service industry players, hence increased office centre employed persons numbers by 20%-25% to roughly 72,000-75,000;
 - C. With increased business stability tenants are likely to require more comfort, thus potential for increased per person take-up from 5,9 sqm to stable economy standards at 7-10 sqm per office centre employee;
 - D. Given low “A” class supply, the elite office centre niche provides increased long-term potential.

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