Riga retail market

Latvia

2010

IMMOSTATE

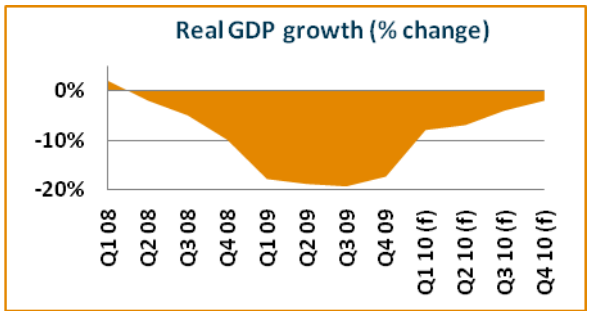
Economy

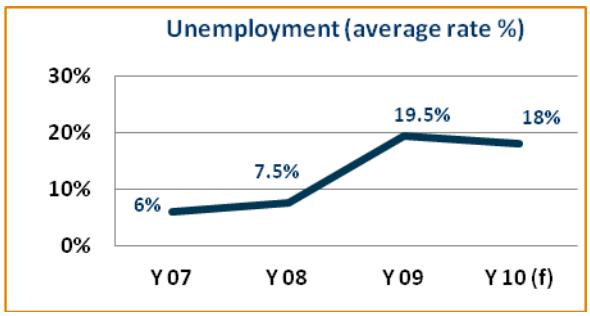
"Despite a fall in GDP of 17.5%, Latvia seems to have achieved something many thought impossible: an internal devaluation, meaning regaining competitiveness not by currency depreciation but by deep cuts in wages and public spending" states the *Economist*.

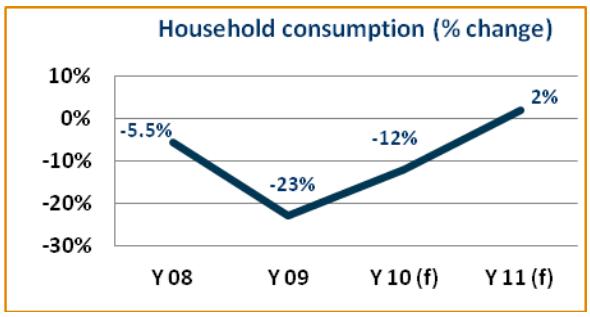
Indeed, early in 2010 the *Standard & Poor's* rating agency upgraded its outlook on Latvia from negative to stable. The shift of local businesses to the export markets has improved the country's balance of trade and led to the much needed current account surplus. Along with overall improvement, Latvian export has become more diverse, evolving from predominately service industries to the increased export of goods. Internally, consumer confidence has been gradually improving since the second half of 2009 despite significant wage declines and household debt burden.

The marginally positive news, however, remain shadowed by the grim unemployment indicators expected to peak in mid 2010. Latvian banking sector remains conservative as 25.5% of the mortgage loan portfolio or some 3.9 billion Lats (5.55 billion Euros) delay at least some payments, recorded by the *Latvian Financial and Capital Commission*.

The upcoming parliament elections and low credibility of the politicians adds uncertainty in the government ranks, in the light of solving two critical economic issues - job (re)creation and budget balancing for Euro adoption.







Central Statistical Bureau, State Employment Agency, Bank of Latvia data.
f – forecast.

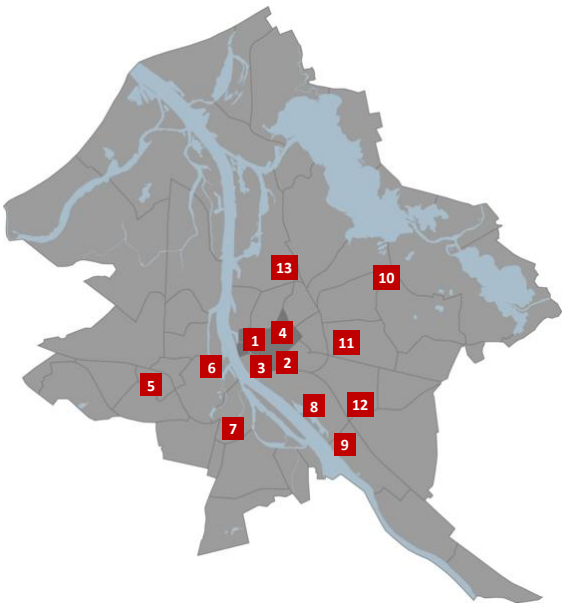
Shopping centres

Supply

Riga shopping centre Gross leasable area (GLA) will reach 405,000 sqm in 2010 (total area: 607,000 sqm).[1] The majority of the shopping centre supply has been delivered to the market prior to 2006.

Riga shopping centre positioning covers all strategic directions. Four (4) shopping centres are located in the Central Business District (CBD) featuring high-end fashion and grocery anchors, while the rest (9) of the centres are positioned alongside main transportation routes and target mostly highway access clientele.

Riga shopping centre locations[2]



	Type	Name	GLA (sqm)
1	CBD	Galerija Centrs	23,000
2	CBD	Origo	27,000
3	CBD	Stockmann	11,000
4	CBD	Galleria Riga	36,000
5	Highw ay	Spice & Spice Home	62,000
6	Highw ay	Olympia	21,000
7	Highw ay	Riga Plaza	50,000
8	Highw ay	Mols	29,000
9	Highw ay	Dole	10,000
10	Highw ay	Alfa	56,500
11	Highw ay	Domina	46,000
12	Highw ay	Azur	20,500
13	Highw ay	Sky & More	13,000
		Total (sqm):	**405,000**

During 2007–2009 the city has added two new completions: *Riga Plaza* (2009; 50,000 sqm GLA), *Sky & More* (2007; 13,000 sqm GLA) and holds one major shopping centre completion in the pipeline for 2010 - *Galleria Riga* (36,000 sqm GLA). Meanwhile, same period notable extensions include - *Spice Home* (22,000 sqm GLA) in *Spice* and *Cinnamon cinema* (4,000 sqm total area) in *Alfa* shopping centre.

Riga Plaza

On a country scale Latvia sits above EU-27 average (225 sqm per 1,000 inhabitants) and presents the same per capita shopping centre provisions as more mature markets – UK, France and Spain, according to *Cushman & Wakefield*.

Regionally all Baltic capitals have grown quite significantly with Tallinn leading the way (1.09 sqm shopping centre GLA per capita) followed by Vilnius (0.62 sqm/per capita) and Riga (0.57 sqm/per capita). However, Riga being the largest and most populated Baltic capital has accumulated one of the highest EU capital shopping centre concentration ratios of circa 80% from the total Latvian supply.

Shopping centre GLA per inhabitant (sqm)

	Y07	Y10
Riga	0.35	0.57
GLA	250,000	405,000
Inhab.	722,000	712,000
Vilnius	0.52	0.62
GLA	283,000	335,000
Inhab.	543,000	540,000
Tallinn	0.91	1.09
GLA	365,000	442,500
Inhab.	400,000	405,000

In the mid-term perspective due to scarce financing and significant existing supply any new shopping centre developments, if approached, will be handled with extreme caution. Most of the activity in the shopping centre front is expected in extensions, remodeling and even rebranding for some of the poorer performing centres.

For developers with a longer term approach selective development opportunities will be provided as a part of evolving Riga infrastructure (completion of the Southern Bridge and launch of the Northern Transport Corridor).

[1] *Immostate defines shopping centre as shopping purpose built unified facility with a minimum 10,000 sqm GLA and at least 30 retailers.*
[2] *Galleria Riga to be completed in 2010.*

Demand

Riga shopping centre culture is relatively new, but grown to be well appreciated among the inhabitants and visitors. In just over 10 years Riga shopping centres have covered the majority of strategic locations becoming main drivers of the consumer spending.

As a result of the attracted popularity, even during heavy recession (2008-2009), shopping centres and their respective tenants have performed better than other retail segments. However, in less severe form the economic turmoil has also left a mark on the previously invulnerable shopping centre industry.

Reduced retailer sales turnover and the corresponding tenant lease review requests have initiated a new era of proactive centre management, requiring great skills in balancing the satisfaction of core tenants with the overall performance of the centre. In addition, as portion of smaller tenants have failed established industry frontrunners and new shopping centre developments are reporting previously unprecedented space vacancies of approximately 5% and 15%, respectively.

Finally, as long as consumer spending continues to be under the pressure of the overall economic situation, the tenant – owner relationships are likely to remain based on compromises and most often tenant favorable lease corrections.

Asking shopping centre lease rates (1 sqm/month)

	Anchor > 1,500 sqm	500 - 1,000 sqm	200 - 500 sqm	Prime < 200 sqm
Y 07	€ 6 - € 10	€ 10 - € 15	€ 18 - € 25	€ 35 - € 55
Y 08	€ 7 - € 12	€ 12 - € 15	€ 15 - € 25	€ 30 - € 40
Y 09	€ 7 - € 10	€ 8 - € 12	€ 10 - € 20	€ 25 - € 35
Y 10	€ 5 - € 10	€ 7 - € 12	€ 8 - € 15	€ 25 - € 35

Yields

The diminishing appeal of commercial real estate as an investment has kept most international investors distant from any closing activity in Riga during 2009.

Nonetheless, as the country is gradually recovering from the economic freefall some scouting activity is returning to the Riga investment market.

Due to solid Riga shopping center performance, the potential investment bid-ask gap has widened for the majority of the centres during the recession. Most of the owners are staying firm on their asking indicators, especially as the confidence and prospects of their assets improve.

Contrary, unfamiliar outside investors see the Baltic capitals as unstable markets for at least next 18-24 months, hence, systematically increasing bid investment return levels to account for elevated risk.

Investor bid yields (%)[3]

	Y07	Y08	Y09	Y10
Yield	5% - 7%	7% - 9%	8% - 11%	9% - 12%

The single most positive outcome from the recession is the change of market player perception from short- to long-term. Owners are more aware of the tenancy and management related risks, occupiers have become more assertive in premise identification and long-term fit, meanwhile lenders are resuming conservative lending based only on careful due diligence and borrower review.

All the positive industry corrections together with visible economic recovery shall stabilize the core Baltic markets and allow for bid-ask investment gap to narrow to a 7-9% yield range, which reasonably reflects the balance of risks and returns in the region.

[3] *Due to lack of comparable transactions, the 2009 and 2010 yield levels are only indicative measurements of investor balance of risk and returns.*

Big box

Supply

Riga big box retail supply is characterized by large scale mostly highway access grocery supermarket and warehouse "do-it-yourself" (DIY) store formats.

Rimi (subsidiary of ICA AB) and *Maxima* (Maxima Group) brands dominate the Riga grocery market, each holding approximately a quarter of the market share.[4] Other evolving market participants include *IKI* (Coopernic Partners) and *Prisma* (S-Group).

Eight (8) *Rimi* and two (2) *Prisma* hypermarkets anchor Riga shopping centres. All other grocery retailers operate as standalone buildings or ground floor tenants.

Contrary to the established market operators, 2009 proved to be an early exit year for the latest market newcomer - Estonian grocery brand *Selver* which closed all existing stores and recalled any on-going developments in Latvia.

Largest Riga grocery formats/store (as of 2009)[5]

	Hypermarket 3,000-10,000 sqm	Supermarket 1,000-3,000 sqm	City format <1,000 sqm
Rimi	10	16	27
Maxima	3	5	48
IKI	1	9	11
Prisma	2	0	0
	16	**30**	**86**

The DIY market is likewise distributed among several large operators. The notable Riga players include *K-rauta,* a member of the Finnish Kesko Group, operating 3 circa 10,000 sqm warehouse DIY stores. Meanwhile, *Depo* and *Kurši* - two local brands, each represent additional 4 Riga DIY stores.

Rimi hypermarket format

Demand

As expected during the time of sharp decline in consumer spending and construction related activity, the grocery and DIY stores have remained conservative in the pursuit of new space.

Largest grocery retailers - *Maxima* and *Rimi* - both have been set on existing space inventory optimization. In selective cases operators have closed weaker performing outlets, but focused on rebranding or expanding locations with most growth potential.

Last year has been a very active year for *IKI*. Following a 2009 takeover of the local *Nelda* brand, the operator has openened 18 stores under the *IKI*, *IKI express* and *Cento* brands.

The largest 2009 grocery lease transaction in Riga has been the *Prisma* hypermarket anchor of circa 10,000 sqm in the *Riga Plaza* shopping centre.

Yields

As grocery and DIY operators continue to battle for market control in their respective fields, the necessity for outside capital could become essential for achieving an edge. Especially as conventional real estate financing remains hard to obtain.

In this sense, during 2011-2012 some of the operators may resume targeting sale-leaseback deals to free portions of invested capital, offering investors conservative, yet relatively secure 7-9% yield levels.

[4] *IGD retail analysis.*
[5] *Companies websites, city format includes discount brand stores.*

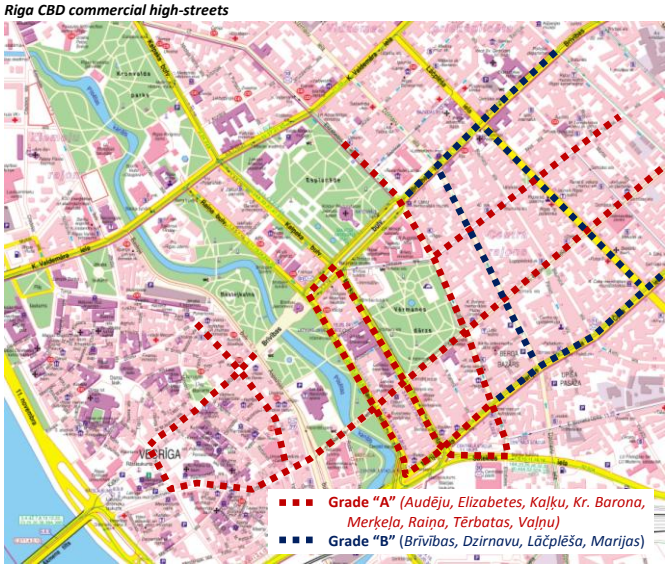
High street

Supply

Located mostly on the ground floor of Riga CBD heritage buildings the overall high street supply is predominantly fixed.

Grade "A" high street locations attract the highest pedestrian flow in Riga, serving as paths to various points of interest. Meanwhile, Grade "B" high street locations are alternative pedestrian routes with greater public and private transportation influence.

Riga CBD commercial high-streets



After years of very limited high street space, the available supply increased dramatically during 2008-2009, due to unprecedented number of retailers and restaurant operators failing.

Entering 2010, after 18 months of deep freeze, the activity is gradually returning. Nonetheless, due to very fragmented high street location ownership structures and lack of general municipal guidelines, the work at times is chaotic and understandably directed to fill vacancies with the first tenant available.

A positive change to the homogeneous Riga high street retail supply is the newly developed *Milda tirgus* retail market (set to open June 2010) fully leased by *Immostate* prior to the delivery. The *Milda tirgus* retail market is located adjacent to the Riga Central Railway station with 42 different Latvian food industry producer occupied retail spaces (15-45 sqm each).

Demand

High street lease space absorption is gradually improving.

In fact, due to reduced lease rates and opportunities for tenant favorable covenant terms, most of Riga Grade "A" and best Grade "B" high street space has been reabsorbed as of Q2 2010.

Asking high street lease rates (1 sqm/month)

	Grade A >100 sqm	Grade A <100 sqm	Grade B >100 sqm	Grade B <100 sqm
Y 08	€ 25 - € 50	€ 15 - € 25	€ 15 - € 25	€ 10 - € 20
Y 09	€ 15 - € 30	€ 10 - € 15	€ 10 - € 15	€ 5 - € 10
Y 10	€ 12 - € 22	€ 7 - € 15	€ 5 - € 10	€ 3 - € 8

As the economy is showing signs of recovery, many start-up and better performing existing businesses, especially in small scale retail and food (bistro, restaurant, etc) service industries, have been active in seeking prime locations utilizing significant lease collapse.

For owners, however, improving tenant interest is more a short-term fix. Pressured by the urgent need for cash flow, owners are signing mostly short-term (12-24 months) leases reserving the right for a rate review upon contract maturity.

With further market stabilization and prospective high street lease rate rebound, many tenants, especially start-ups, will be challenged to stay competitive to maintain newly occupied prime locations.

Kaļķu street (Grade "A" high street)

Yields

Historically, Riga high street investment has been scattered and mostly undertaken by local entrepreneurs. As lease rates change in the same direction as sales prices, the yields have remained rather constant over different market cycles.

High street owner rental yields (%)

	Grade "A"	Grade "B"
Yield	7% - 10%	5% - 8%

Forecasts

- Along with the economy, the retail market is likely to stabilize further during 2010-2011. However, tangible improvements in the household disposable income may not appear until mid 2011 or even later.
- The significant shopping centre supply and unclear timing of the space demand rebound will keep new developments modest.
- During 2011-2012, most of the shopping centre developer and big box operator activity is expected in the existing location expansions and other value adding processes.
- In a longer term, the evolving Riga transport infrastructure will provide selective locations suitable for new ground-up developments for mid-size shopping centre and big box formats.
- The necessity for any larger retail development schemes in Riga remains unclear and for the most part dependant on the socio-economic factors.
- Throughout 2011 the lease rates will remain at current levels. Selective shopping centres and Grade “A” high street locations my experience slight appreciation, nonetheless, this will not constitute a market trend.
- Many start-up businesses now taking up previously unaffordable space will be under pressure to stay competitive to account for eventual prime location lease increases.
- As some business failures are reasonably foreseeable, especially for local non-branded high street retailers, the prime space shall reopen for longer term merchants.
- Granted continuing lobby in the municipal ranks, Riga CBD may begin experiencing transformation of the high street patterns, introducing pedestrian streets outside of Old Riga. Such systematical municipal approach may encourage, larger high street operator groups to enter Riga.

Contact information:

Edgars Bukševics

Development Director

edgars@immostate.lv

Agnese Groševa

Commercial leasing

agnese@immostate.lv

IMMOSTATE

Immostate SIA

Alberta 12 – 2,

Riga, LV1010

Latvia

Tel: +371 6735 8020

Fax: +371 6735 8021

www.immostate.lv