

Office rental market overview, 3rd quarter

The autumn has brought changes in the office rental market. The end of the annual leave period and the beginning of a new academic year at educational institutions has caused an increase in the activity. While tenants are increasingly faced with limited choices, the supply of office space still allows selecting the best and most appropriate solution. Although the office space supply continues to decrease, the economic activity and the prospects of development of Latvia in the euro area in the coming years will not motivate real estate developers to construct new office buildings.

Offer

Currently the office space rental market in Riga offers Class A and B lease space with total area of 500 000m² in 65 office centres. Approximately 20% of office space which is leased out and free are located in Class A buildings. As most of the Class A buildings are used for commercial banking purposes, opportunities to lease office space of this class are limited, so that B-class office space with high-standard technical equipment is offered to tenants as an alternative. In contrast to Class A office space, location of the Class B office buildings is less successful.

In Riga a number of Class A office blocks are under construction, so that a growth of this class commercial space supply is expected; it is considered that the most promising projects are the Skanstes Street commercial buildings, as well as a part of Kipsala where the existing "Solar Stone" soon will be complemented by the business centre "Z-Towers", although there is still not certain whether this project will also include office space. Also the office space projects located in the central part of Riga are under development.

During the next six months there is also expected an increase in the supply of office space by 50 000m² when the State Revenue Service's new building at Talejas Street 1 will be put into service. After moving to the new building the space presently occupied by different structural units of the SRS at fourteen different locations will become vacant, so that premises of different class and size, most of which are located in the central part of Riga, will be available in the office space rental market.

Demand

The statistical data consolidated by ARCO REAL ESTATE show that the most demanded office space does not exceed 150m². The highest class office space is mostly demanded by companies, which employ at least ten persons, but the space of Class C is favoured by companies of different industries when starting a business with a few employees, or companies which can not or do not want to move to Class A or Class B facilities due to their limited budget or economically favourable location. Class B rental areas most often are searched by various consulting or retail firms who are not satisfied with the technical condition of their current premises.

The large office rental space exceeding 800m² in most cases is demanded by international companies which mostly are engaged in activities related to financial intermediation, insurance and IT services. Also call centre companies are interested in office space of this type. The tenant move to smaller area or lower class offices will continue for at least the next three years; this trend is associated with the slow improvement of the economic situation in the country and the optimization of expenses of tenants.

Available office rental space

In the existing office buildings in Riga there are no available rooms or that the rental supply has decreased; for example, the number of vacant premises in the class A and B buildings has been reduced to 7 - 12% of the total number of leasable offices, depending on location. At the same time, the Class A and Class B office building owners do not have problems as to attracting tenants to premises of an area not exceeding 150m².

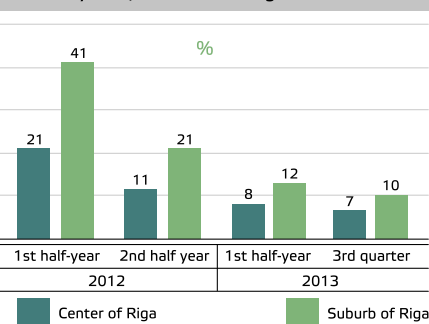
The highest vacancy rate is still to be found in non-renovated Soviet-era office buildings or industrial complexes with low levels of interior decoration: vacancy rate of the Class C office space is from 19 to 29%.

Class C space vacancy rate figures allow long-term tenants to get a relatively cheap office space, making themselves the necessary improvements before the start of the tenancy period. Sometimes space owners find a possibility to partially or fully compensate the long term investments made by the tenants in improvement of the leased space.

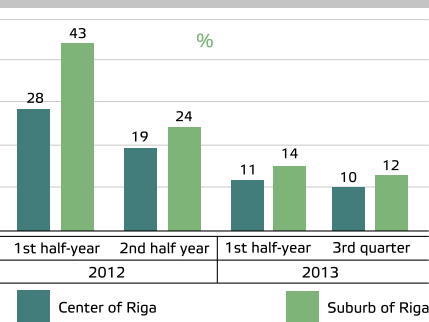
Market indicators, 3rd quarter, 2013

Employment	↑
Inflation	→
Consumer confidence	↑
Investor confidence	→
EURIBOR rate	→
Office rental prices	↑
Available office space	↓

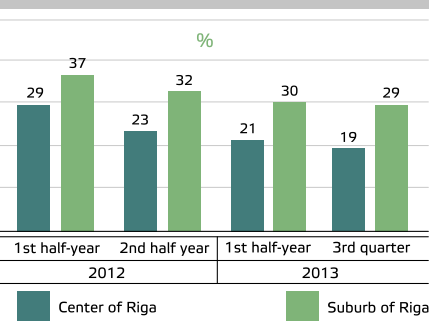
Vacancy rate, A class buildings



Vacancy rate, B class buildings



Vacancy rate, C class buildings



Rental prices

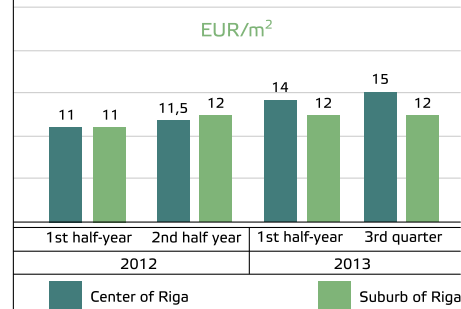
A minimal rent increase was observed in the 3rd quarter. The office space owners are prevented from a more active rent increase because they are not sure that the tenants will be able to pay the rent during the heating season. Also the reluctance of owners to experience frequent tenant rotation slows down rental prices.

In some cases, the rent payable for Class A space may be higher than 20 EUR/m², but the average rent is 12 - 15 EUR/m² with an annual average rent increase of 7-8%, while the rent payable for Class B space during this period was 7-8 EUR/m² with an average rent increase of 5-7% per annum.

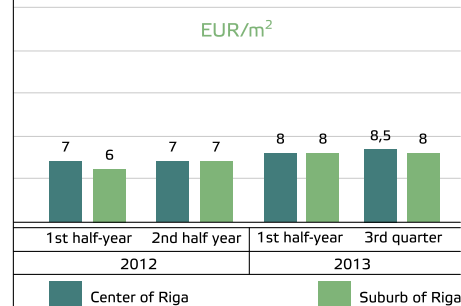
Trends and forecasts

- Decrease in the number of vacant offices, now also reduces the number of rental transactions.
- A deficiency of large office space is being formed.
- Within six months, the supply of class B and C offices will increase and this will initiate a drop of rent amounts payable for this class offices.
- Increasing demand for furnished offices that are more appropriate for the lease term of up to one year.
- Real estate developers are still not convinced that the demand for office space in the future will be stable and predictable, so the number of new projects in the next few years will be limited.
- The emergence of new offices in the long run will depend on the increase of the country's export volume and the amount of available skilled labour force.
- Only improvement of solvency of tenants and an increase of the rents will contribute to the activity of foreign investors in the field of construction or renovation of new office buildings.
- The optimal rent limit, within which Class B office building construction could start, is 12 to 14 EUR/m², depending on the average occupancy rate planned.

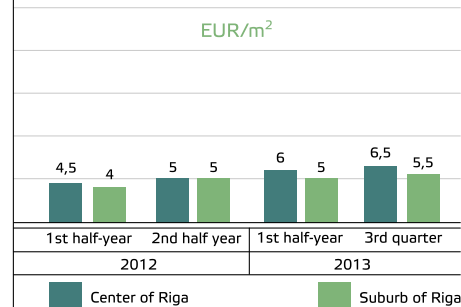
Typical rental prices in class **A** office buildings



Typical rental prices in class **B** office buildings



Typical rental prices in class **C** office buildings



ARCO REAL ESTATE is one of the largest real estate companies in Latvia. It was founded in Estonia in 1992. The company is listed on the Tallinn Stock Exchange since June 2007.

ARCO REAL ESTATE commenced its activity in Latvia 16 years ago and currently provides services in Riga, Saulkrasti, Jelgava, Limbaži, Liepāja, as well as in Jūrmala and Ventspils. The company employs about 70 specialists of high professional qualification.