



# COMMERCIAL SPACE MARKET OVERVIEW

## RIGA | 3<sup>rd</sup> QUARTER | 2014

## Commercial Space Market Overview

### Office rental market

In 2014 – along with improvement of the economic situation - it has been observed that the entrepreneurs want to improve their working conditions. For this reason, a two-way development is characterizing the office space market – the proportion of vacant space being in good condition is decreasing which is gradually increasing also the rents to be paid for this space, while the existing office premises which are in poor technical condition and the owners of which are not ready to make improvements in the premises, are being vacated. Lessees are increasingly faced with limited options, looking for office space compliant with their requirements.

#### S U P P L Y

Currently, the supply in the office rental market in Riga contains the A and B Class lease space of more than 600 000m<sup>2</sup> in 71 office centres. Since most of the Class A buildings are used for commercial banking needs, opportunities to lease space of this class are limited, so tenants are offered Class B office space with high level technical equipment as an alternative.

Class A office space supply has increased this year. The sales process of the *Latvijas Krājbanka* office building located in Jāņa Daliņa Street is over; this building in the future will be known as *LNK Centre*. Also, the Class A office space supply is replenished with a new office building at No. 1, Vaiņodes Street, as well as the new State Revenue Service (SRS) building in Talejas Street.

After the move of the SRS to the new premises, its previous office premises in fourteen different places became vacant. They are mostly Class C office premises, but some of them qualify also as Class B office premises, such as premises in the *SWH Business Centre* located in the city centre as well as premises that are located outside the city centre - Brīvības Street 214 (VEF area).

An increase in the supply of Class A commercial space is expected in the future. An example that can be mentioned is the *Z-Towers* project that will soon complement the *Saules akmens* complex located nearby, in Ķīpsala. Office premises in this project will occupy 10 storeys in its south tower. Also *Hanner Group*, by purchasing an appropriate land plot, has demonstrated their intention to erect a new Class A office building in the neighbourhood of Skanstes Street. Launching of new Class B projects is not expected because the current rent level is not profitable for developers.

#### D E M A N D

According to data available to ARCO REAL ESTATE, the most demanded office space is space not exceeding 150m<sup>2</sup>.

The higher-end office space is mostly searched by companies, which employ more than ten people, but the Class C premises are popular among companies in various sectors, which are starting their own business with a small number of employees, or companies whose limited budgets and/or economically favourable location does not allow moving to Class A or Class B premises. It has been also observed that during the last time, among those who are looking for rental premises, more and more often we can see medical centres, as well as various small service providers, such as beauty care establishments, providers of different courses or training as well as private kindergartens.

Along with the overall improvement of standard of living and paying capacity, it can be observed that also the lessees' requirements to office space are increasing. The main factors affecting the choice of office space seekers are: technical condition, location, rent amount, management price and quality, layout compliance, car parking possibilities near the office both for employees and customers.

Similarly, the choice is influenced by several secondary factors, such as ad placement options, façade condition, neighbouring institutions and transport. The most popular places where office space was searched, was the Near Centre, office areas of Skanstes and Dunties Street as well as the Near Pārdaugava.

#### Market indicators, 3<sup>rd</sup> quarter, 2014

EMPLOYMENT	↑
INFLATION	↑
CONSUMER SENTIMENT	↑
INVESTOR SENTIMENT	→
EURIBOR RATE	→
VACANT OFFICE SPACE RENT LEVEL	↑
PROPORTION OF VACANT OFFICE	↓

Source: ARCO REAL ESTATE



#### The main factors affecting the choice of office space seekers are:

- TECHNICAL CONDITION
- LOCATION
- RENT AMOUNT
- MANAGEMENT PRICE AND QUALITY
- LAYOUT COMPLIANCE
- CAR PARKING POSSIBILITIES NEAR THE OFFICE BOTH FOR EMPLOYEES AND CUSTOMERS.

Source: ARCO REAL ESTATE

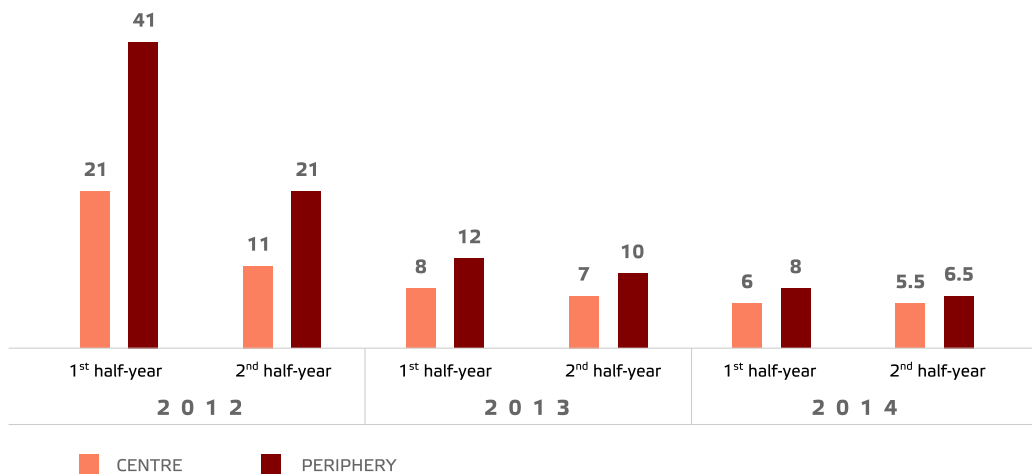
**PERCENTAGE OF VACANT PREMISES**

Decrease of the percentage of vacant Class A and B office premises is still continuing, with the sole exception of Class B office space outside the city centre, where the share of vacant space has increased from 12% to 15.5%. This can be partly explained by the vacated former SRS office premises, and, taking into account market trends, this growth is likely to be only temporary, while the market is re-orientating. The vacant premises may be soon occupied by companies who want to move from Class C office space. Furthermore, these premises might be attractive to those companies who have great difficulty in finding a large office space in one place.

In Class A buildings, the proportion of vacant space in the third quarter of 2014 decreased to 5.5 - 6.5% of the total leasable office space, depending on the location.

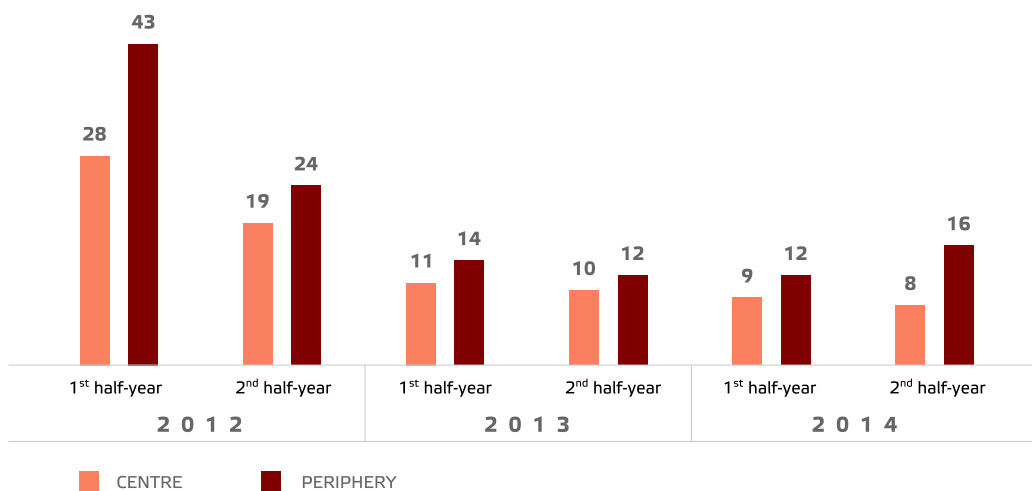
By contrast, regarding Class C office space, which previously had the highest vacancy rate, the vacancy rate has increased even more - up to 22 - 32% depending on the location. This increase has arisen directly due to the premises in poor technical condition. These are mainly non-renovated Soviet-era office buildings or industrial complexes with insufficient finish.

**Proportion of vacant Class A office space, %**



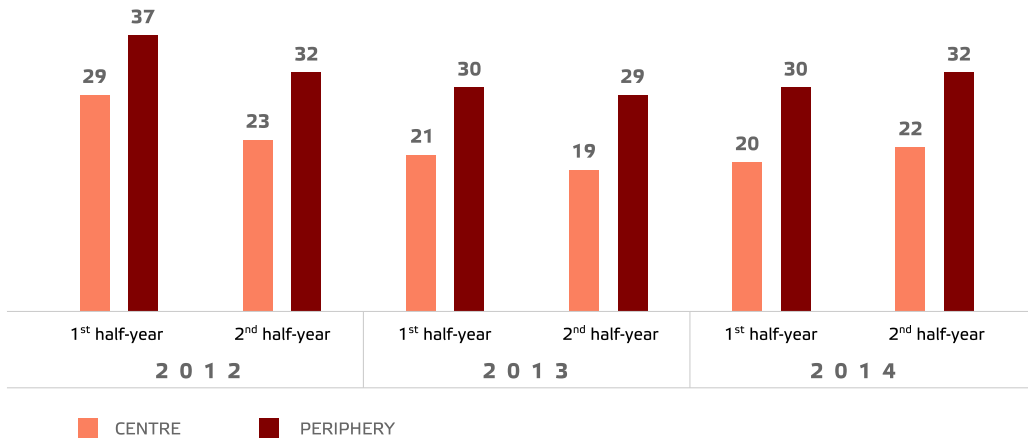
Source: ARCO REAL ESTATE

**Proportion of vacant Class B office space, %**



Source: ARCO REAL ESTATE

**Proportion of vacant Class C office space, %**



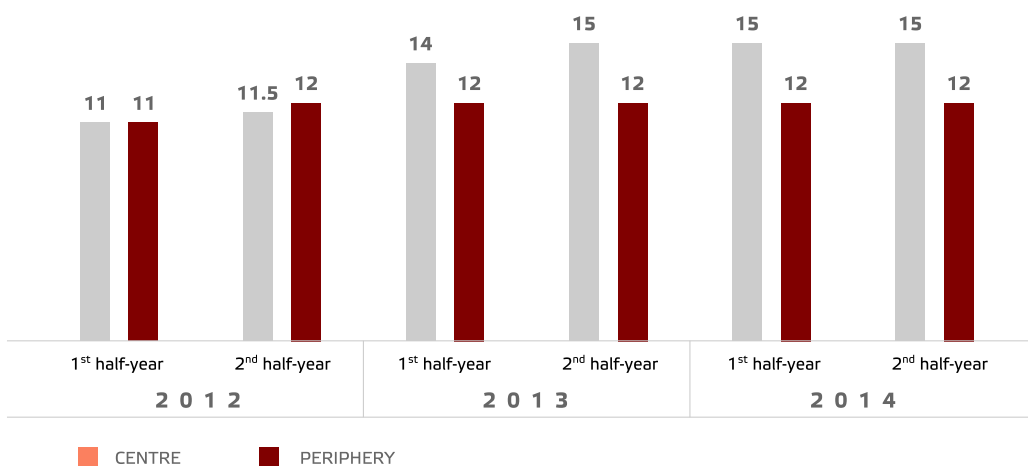
Source: ARCO REAL ESTATE

**RENT LEVELS**

Although rent levels in the Class A and B office segment have a tendency to increase, the growth is very moderate. Often the rent is increased for premises being offered for rent while the rent level is not increased for the existing tenants, so it can be said that the price growth is a gradual process. This trend can be explained by the fact that the office space owners are cautious about whether the tenants will be able to pay the bills during the heating months. Also, the unwillingness of owners to experience frequent tenant rotation hinders rapid rise of the rent levels.

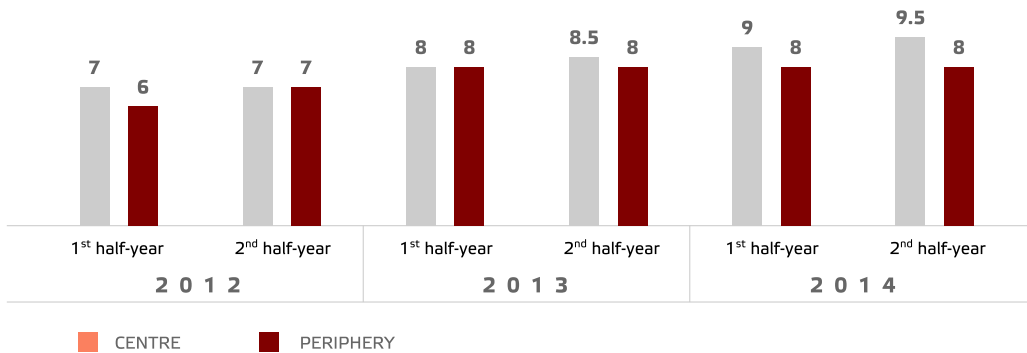
Typical rent level for Class A offices was from 12 to 15 EUR/m<sup>2</sup>, but in some cases the rent level reached 20 EUR/m<sup>2</sup>. Typical rents for Class B office during the year increased to 8 - 9.5 EUR/m<sup>2</sup> depending on the location, while the rent level for Class C offices remained unchanged: 5.5 - 6.5 EUR/m<sup>2</sup> with a tendency to a slight decrease.

**Class A office space typical rent levels, EUR/m<sup>2</sup>**



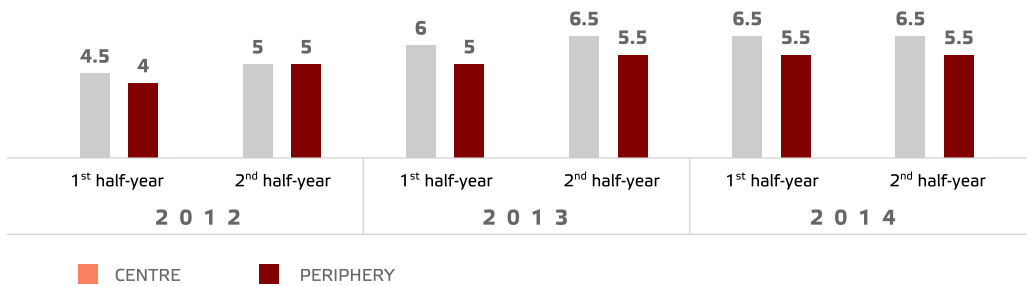
Source: ARCO REAL ESTATE

## Class B office space typical rent levels, EUR/m<sup>2</sup>



Source: ARCO REAL ESTATE

## Class C office space typical rent levels, EUR/m<sup>2</sup>



Source: ARCO REAL ESTATE

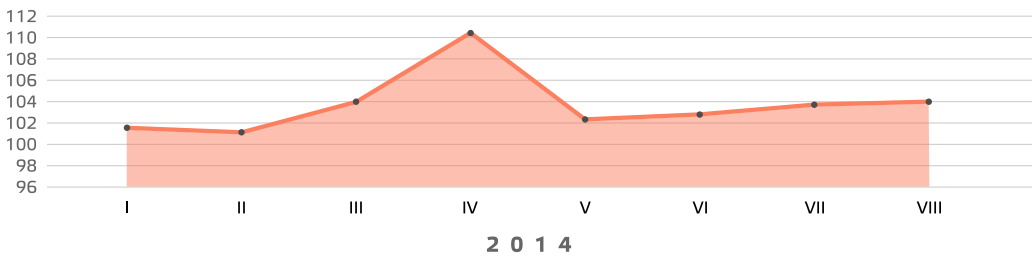
## TRENDS AND FORECASTS

- The decline of number of transactions with office space that occurred in the previous year along with the decrease of supply of vacant premises has stopped, and this year the number of transactions has stabilized.
- The demand for furnished offices that are suitable for the rental period of up to one year is stabilized. This segment is primarily affected by companies' confidence about their future security and stability.
- It is expected that the existing trend will continue and the companies will still wish to improve their working conditions and to move to a higher class offices, vacating the Class C premises being in poor technical condition. Given the small percentage of vacant Class A and B office space, it will accelerate the increase in prices in this segment.
- 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 coming years will be limited.
- Only improvement of tenants' solvency and increase of rent levels will contribute to investor activity in new building or renovation.
- Optimum rent limit, which might cause commencement of construction of Class B office buildings is 12 to 14 EUR/m<sup>2</sup>, depending on the average occupancy planned.

**Retail space rental market**

The increase of the average wage in Latvia has improved also the purchasing power of the people, which has resulted in consumption growth. Retail trade turnover growth as well as the progress in the tourism sector has positively influenced also the commercial space market.

**Retail trade turnover index, %**

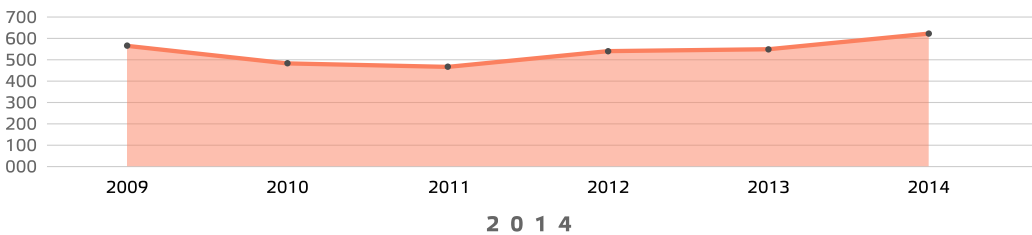


Compared to the corresponding period of the previous year

Source: Central Statistical Bureau



**Total expenditure of foreign travellers, in mill. EUR**



Source: Central Statistical Bureau



The most demanded retail space locations in the 3<sup>rd</sup> quarter of 2014 remained to be the most popular shopping streets in the city centre and the Old Town, where space availability is reduced to a minimum. Despite the fact that these locations are closely related to the flow of tourists, which is subject to seasonality, they are able to provide a stable flow of pedestrians throughout the year. Only retail space belonging to owners, who want to find better tenants, is available for rent.

A specific feature of retail space is that the attractiveness of a retail space is depending on more factors than other commercial premises. So, for example, rents can vary greatly even in locations situated close to each other within the Old City, depending on the flow of tourists. In that part of the Old Town, which is located near the Krišjāņa Valdemāra Street, they are significantly lower than in the streets, along which the main tourist routes are running. Also, neighbouring establishments and even the side of the street where the premises are located, may affect the rent amount. Outside the Old Town, a factor that influences the price is the proximity of a hotel, as some retail companies targeting non-residents are particularly interested in such locations. For these reasons, the Old Town and the main commercial streets of the Riga City centre have a wide range of typical rents. In the Old Town, the typical price range for a medium-area retail space is from 20 to 60 EUR/m<sup>2</sup>, while in the city centre’s main shopping streets this range is from 15 to 30 EUR/m<sup>2</sup>.

Higher rents are typical for tenants operating in the catering sector because premises operated by these companies must comply with a number of specific requirements. Also, a higher generation of waste, regular delivery of goods and higher noise would be taken into account when setting the rent for a catering company. Often, space owners are not able to take into account this factor when calculating the rent, and are not willing to make necessary improvements to ensure compliance of the premises with the needs of the catering company, giving priority to companies operating in other business fields.

There is still a market share of retail space, the rent level of which has increased substantially after the change of ownership. The rent level has increased even by 30-50%. Rent level increase to such a large extent increased significantly also the period of the lease - even up to 1 year. Similarly, the above-mentioned premises have a higher tenant rotation because the traders are unable to achieve sufficient sales volume to ensure that the rent is cost-effective. Often the decision about rent of premises is influenced also by emotional factors.

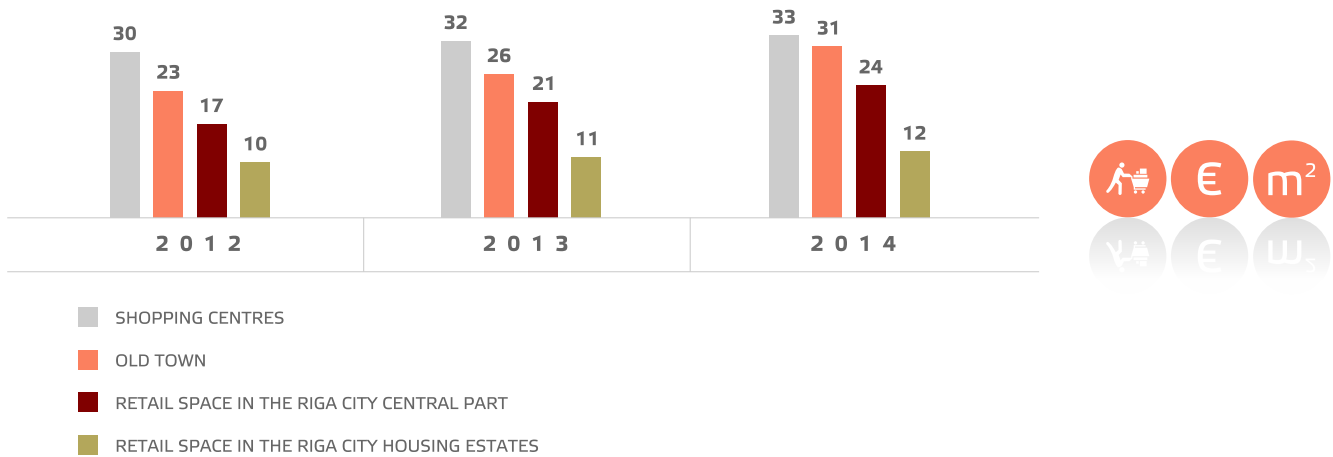


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During the year, at least a minimum retail space rent growth occurred practically in all segments. The smallest increase was observed in Riga housing estates, where the average rent is about 12 EUR/m<sup>2</sup>. Lower prices in this segment are typical for premises located in places with a weak flow of pedestrians. Similarly, lower rents are for large food trading companies, which provide the surrounding businesses with pedestrian flow.

The highest rents still are in the segment of large shopping centres. This is due both to the large flow of customers in those centres and the fact that this price includes also a variety of marketing services. The most successful shopping centres are currently carrying out a gradual change to tenants of a more prestigious brand, because these companies are able to provide a higher turnover, and increase the overall flow of customers in the shopping centre, which creates a positive effect on the rest of the tenants. In certain shopping centres with a smaller flow of customers it is possible to find retail space rented out for 15 to 20 EUR/m<sup>2</sup>.

**Typical retail space rent levels, EUR/m<sup>2</sup>**



- SHOPPING CENTRES
- OLD TOWN
- RETAIL SPACE IN THE RIGA CITY CENTRAL PART
- RETAIL SPACE IN THE RIGA CITY HOUSING ESTATES

Source: ARCO REAL ESTATE





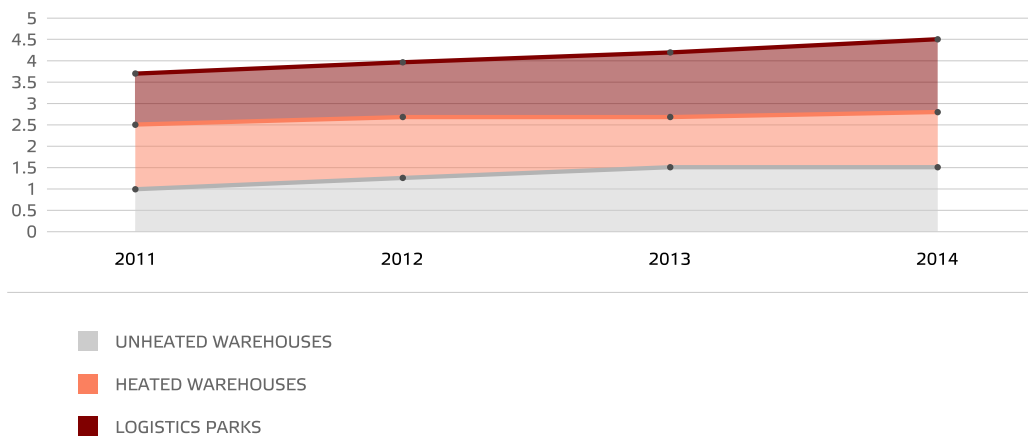
## Industrial and warehouse space rental market

In 2014, a significant demand for quality space was still observed in the industrial property market. This is space with heat insulation and high-quality flooring connected to the public utilities networks. For warehouse premises, an important factor is existence of transport driveway ramps and appropriate transport gateway for easy loading and unloading of goods. Another important factor is proximity of the location to strategic roads for transportation of goods, adequate ceiling height and floor strength, as well as factors relating to protection of goods, such as fire safety. But for industrial premises, an important factor is existence of all the necessary public utilities, possibility to use increased electrical power consumption equipment, as well as factors associated with employee amenities such as parking place for cars of the employees.

In the buildings constructed in the last decade in and around Riga (Mārupe, Jaunmārupe, Ķekava), which corresponds to the above-mentioned conditions, the average rent is from 3.50 to 5.00 EUR/m<sup>2</sup>, but the supply of such premises is very limited. Higher prices are typical only for premises that meet specific requirements, such as suitability to storage of medicinal products or tobacco products. In some cases, the rent is not determined for the area, but for the number of pallet places used. Most requested areas are from 800 to 1500m<sup>2</sup>.

In the buildings erected during the Soviet era the average rent is from 1.00 to 2.30 EUR/m<sup>2</sup>, depending on whether the premises are heated. In unheated premises the rent usually does not exceed 1.50 EUR/m<sup>2</sup>. A characteristic feature of the buildings erected during the Soviet era often is irrational number of auxiliary premises, as well as the unsatisfactory technical condition, such as uneven floor surface requiring additional investment to enable the lessee to use them for their needs. These buildings still occupy a large share in the industrial and warehouse space market.

### Average industrial space rent levels, EUR/m<sup>2</sup>



Source: ARCO REAL ESTATE

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