

Logistics assets gaining the momentum

Investment Volume
EUR 492 mln

Prime Office Yield
5.25-5.50%

Prime S/C Retail Yield
7.00-7.25%

Prime Logistics Yield
6.75-7.00%

*Arrows indicate changes from H1 2020

Figure 1: Via 3L Logistics Complex



Source: Richard Mihhels, 2021

KEY POINTS

- Economic sentiment indicators in H1 2021 demonstrate positive changes in the EU and the Baltics as well. GDP growth is expected to stabilize already this year in the Baltics, increasing in Latvia by 4.0%, Estonia 3.8% and Lithuania 3.2%.
- Over H1 2021, CRE capital investment volume in the Baltics reached EUR 492mln, which is 64% increase compared to H1 2020.
- Investors were primarily looking for industrial assets which constituted 33% of the total investment transactions, followed by offices (28%) and retail (13%) assets.
- Total retail investments in the Baltics reached ca. EUR 136mln, almost 2.5 times more y/y, with Lithuania being the most active market (65%). The acquisition of two DEPO DIY stores by Corum were identified as the largest retail acquisitions in the Baltic region.
- Modern offices remain an attractive investment opportunity, however the market dictated the downward prime office yield trend compressing the prime office yield to 5.25 - 5.50% and for the secondary offices to 6.75 - 7.25%.
- Warehousing and logistics keep attracting substantial e-commerce, production and retail clients as the online services have expanded during the lockdown time. Capital investment into the segment added up to ca. EUR 161mln in H1 2020.

ECONOMY

The sharp fall of the economic growth in 2020 has already been felt in real estate sector, reflected in asking prices, yields, and borrowing rates. However, in the current pandemic, we do not expect significant changes in those market indicators as economic activity was temporarily weakened but not directly impacted. Correspondingly, the government identified and implemented funding measures and continues to support faster growth in the future.

Economic sentiment indicators in H1 2021 demonstrate positive changes in the EU and the Baltics also. For the next and further coming years we should observe economic growth. Oxford Economics forecasts that GDP growth in the Baltics after contracting in 2020 has started to stabilize, reaching ca. 4% growth starting from 2022. According to forecasts a gradual GDP increase in 2021 in Latvia by 4%, Estonia 3.8% and Lithuania 3.2% will be seen.

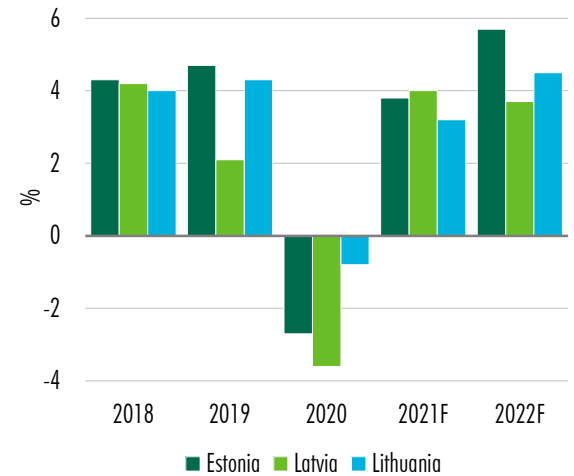
Temporary deflation at just ca. 0.2% in 2020 was observed in Estonia and reduced growth in the annual inflation rate in other Baltic countries mainly was determined by the fall in energy rates, slower increase of food product prices while services prices amplified. Estonia in H1 2021 y/y experienced ca. 5% inflation, taking into account last year's low reference base, and Lithuania 3.6%, although in both countries inflation is expected to return to the pre-pandemic healthy development level already during this year. In Latvia inflation in H1 2021 y/y is 2.7% and overall is expected to return to an annual average of 2% by 2023.

While the short-term economic outlook is good further expectations are heavily dependent on the development of containing the impact of the COVID-19 pandemic, policy response to it and production decisions in major commodity producers.

INVESTMENT MARKET

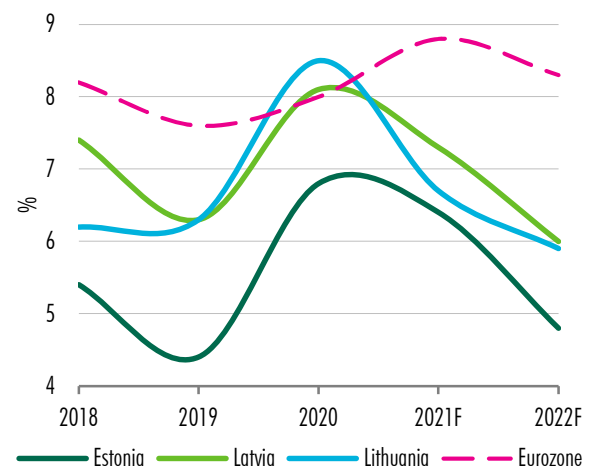
Over H1 2021, investment transaction volume in the Baltics reached EUR 492mln, which corresponds to 164% of the total transaction volume observed over H1 2020. Semi-annual investment volume has increased substantially, and the market remains active with the prime assets being instantly consumed in the market. Investors chose industrial type assets the most which constituted 33% of the total investment transactions. Retail and office

Figure 2: Annual GDP growth (% y/y)



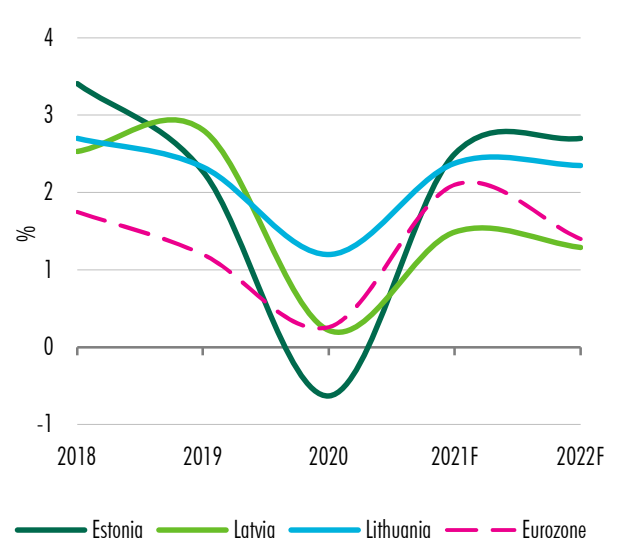
Source: Oxford Economics, CBRE Baltics, 2021.

Figure 3: Unemployment Rate



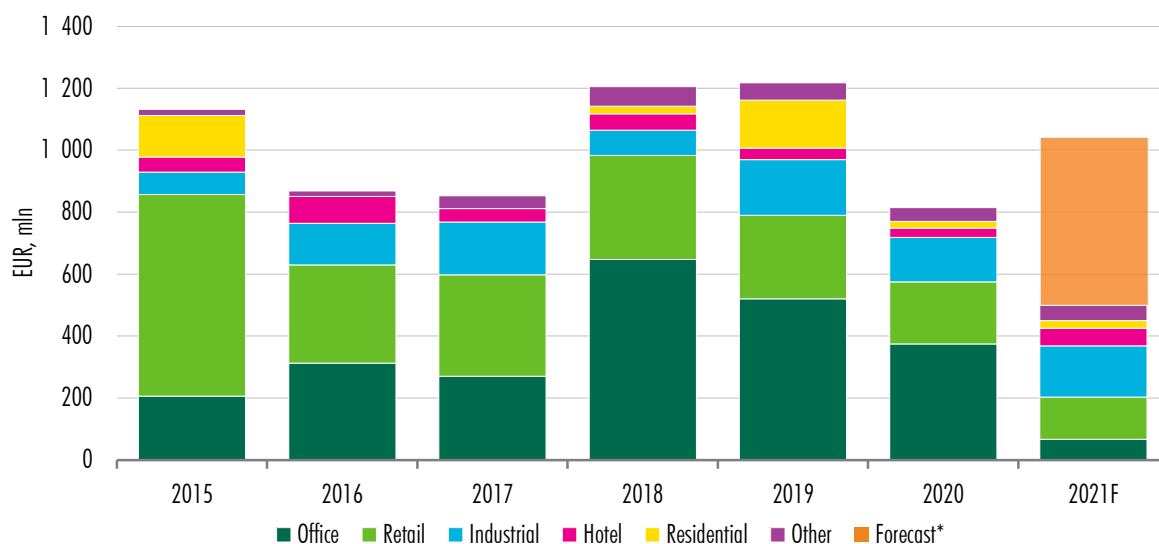
Source: Oxford Economics, CBRE Baltics, 2021.

Figure 4: Annual Inflation Rate (y/y)



Source: Oxford Economics, CBRE Baltics, 2021.

Figure 5: Investment Volumes by Main Use 2015 – 2021F



*Currently ongoing transactions to be finalized by December 2021

Source: CBRE Baltics, 2021.

properties were also demonstrating relatively robust investment levels, accounting for 28% and 13% of the total investment volumes, respectively. Showing more certainty and opportunities in Baltic investment market for foreign investors, the market share of local investors has decreased to 62% from 75% in 2020.

OFFICES

The continually expanding Baltic office market remains strong and relatively resilient to the pandemic uncertainty. Even though office transactions in H1 2021 reached only 35% of the volume observed in H1 2020, the Baltics' office market still holds strong interest among local and international investors.

In the Baltics, the most important office market deal was associated with acquiring the *Uniq Business Center* in Vilnius CBD and *Z1 Offices* in Riga. The deal was signed between real estate companies Eastnine and Vastint.

The office market of Baltic capital cities has been growing at an unprecedented pace for the past few years and showed a high level of confidence in investments. In H1 2021, 82% of the overall office transactions in Lithuania took place in Vilnius and accounted ca. EUR 23mln; in Latvia the entire office transaction volume of ca. EUR 18mln was gathered in Riga, while in Estonia only 11% of total investment transaction involved office assets, all of which were located in Tallinn.

Since modern offices remain an attractive investment opportunity, the market dictated the downward prime office yield trend in Q2 2021. Currently, the prime office yield is compressed to 5.25-5.50%. As for secondary offices, the yield was advised at 6.75-7.25% and remains relatively higher due to weaker covenant strength in such business centres and the higher risks associated with such investments.

RETAIL

The retail sector was among the last ones to revive after the pandemic restrictions. Since social interaction is inevitable in stores and shopping centres, the sector was forced to reconfigure the basis of operations. Nevertheless, the total retail transactions accounted for around EUR 136mln. Non-surprisingly, the biggest CRE investment deals in the retail sub-sector were evident among DIY store market players which were relatively mildly affected by the pandemic induced consumer habits. The most notable transaction was witnessed in Lithuania, which was the driving country in terms of retail investment volume. In Vilnius, Corum acquired above 30,000 sqm *Depo DIY* store on a sale and leaseback basis. Another noteworthy deal was evident in Klaipeda where another over 20,000 sqm *Depo DIY* store sale and leaseback deal was conducted between Corum and Depo. In Latvia, the most significant retail transaction happened with

shopping centre *Valdeka*, located in Jelgava, where over 14,000 sqm of retail space was sold by Lords LB Baltic Fund III to a private investor. Commercial premises in *Kalaranna District* which is a new development of a residential seaside district in Tallinn, worth EUR 13.40mln was sold by Pro Kapital Group making it the most notable retail transaction in H1 2021 in Estonia.

The year 2020 and H1 2021 revealed that the retail industry has no such thing as one-size-fits-all. There is a considerable variation in various retail branches' performance. While grocery and DIY stores demonstrated solid performance, experience-orientated retail, entertainment, leisure and specialty stores trailed behind non-essential retail, had their operations impacted more severely with some of them being unable to operate at all. And such observations are reflected in the yields. While the supermarket yield remains at around 6.25-6.50%, shopping centre yields have fluctuated at around 7.00-7.25% for prime assets and around 8.50% for secondary properties in the Baltics. Despite market evidence suggesting that retail properties may transact at low levels in the near to mid-term future, some degree of resilience is still noticeable in favourable segments of the market.

INDUSTRIAL

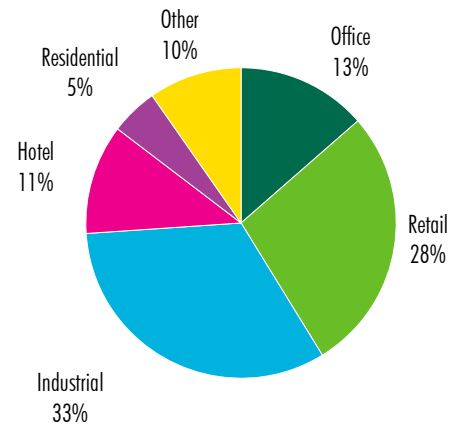
The combined logistics transactions added up to ca. EUR 161mln across the Baltics or 33% of all transaction volume. Estonia was the leading country of all the Baltic states in terms of industrial investment volume (43%). The warehousing and logistics facilities attract substantial e-commerce, production and retail clients as online services have tremendously expanded during the lockdown periods. Industrial assets gain attention from various investors, although they are looking at the market in the Baltics with caution, because falling yields and decreasing NOI, together are bringing up the asset prices.

One of the most outstanding market transactions in the Baltics throughout H1 2021 was the acquisition of a ca. 90,000 sqm logistics complex in the outskirts of Riga – Dreilini, where SG Capital Partners Fund I in cooperation with Swedbank redeemed all shares from SIA Beinits and SIA Balt Cargo Solutions.

A major sale and leaseback transaction between Loginvest and East Capital Real Estate IV was signed

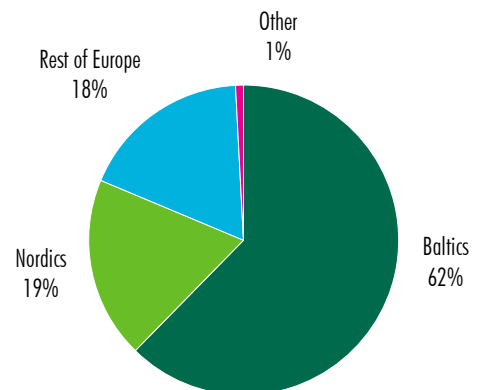
in Estonia, comprising of 33,000 sqm of logistics centre VIA 3L on the outskirts of Tallinn, however prime location for logistics centre. In Lithuania the acquisition of Arginta Group industrial space on the edge of Vilnius city was the most notable industrial transaction so far this year. A purchasing contract was signed between Eften Capital and Arginta Group in Q1 2021. Arginta is identified as one of the most notable industrial sector transactions of the half year in Lithuania, mainly due to its core strength of reliable tenant carrying buoyant demand and strategic micro-location. Another note-worthy deal took place in Panevezys where Eften Capital purchased around 20,000 sqm of production facility for EUR 10mln. The property guarantees stable cash flows for the investor as a result of the strong covenant offered by the international tenant AQ Wiring Systems. The prime investment yield has also showed similar strength to the retail and offices sub-sectors. After the long-standing yield of 7.25%, the market has brought

Figure 6: Investment volumes by sector



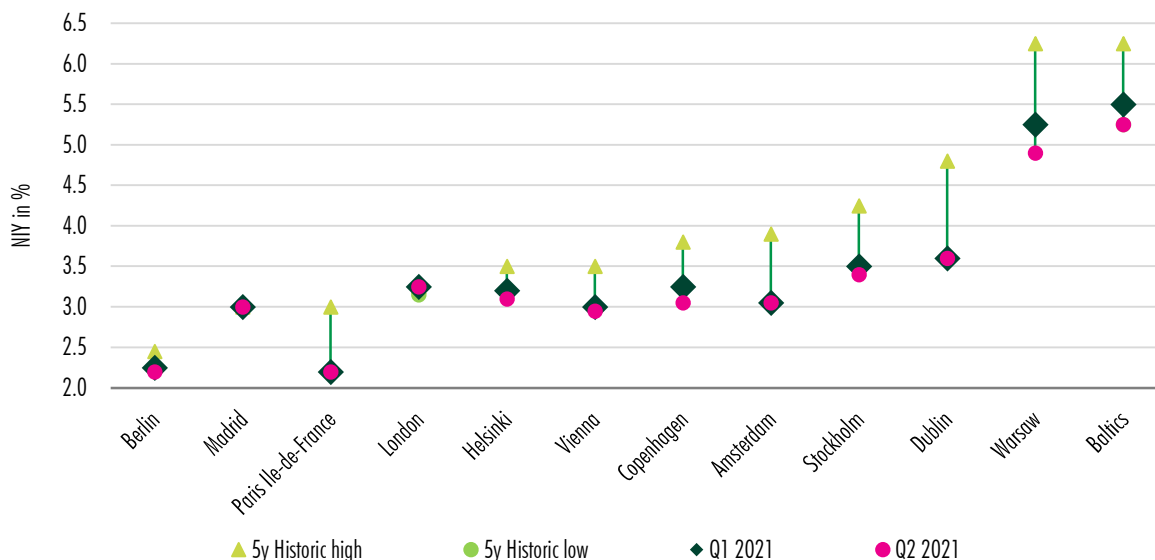
Source: CBRE Baltics, 2021.

Figure 7: Investments by purchaser's origin



Source: CBRE Baltics, 2021.

Figure 8: Prime Yields for Multi-family historic bandwidth in EMEA cities



Source: CBRE Research, 2021.

the prime logistic asset yield in the Baltics to the lowest level ever observed of around 6.75-7.00% as of Q2 2021.

ALTERNATIVE

The global health crisis has, to some extent, upended traditional real estate investment choices. In many sectors, the market values have remained surprisingly resilient, supported in part by the massive scale of government and central bank interventions. The crisis forced investors to take a broader look to the market and search for more secure bets with the high growth potential in terms of future outlook. Similar to 2020, the opportunities seemed to abound for investors who are eager to exploit the economic crisis outcomes of distressed sales.

Multi-family housing has proven to be much more resilient against an economic downturn than other sectors. Europe has seen dramatic growth in multi-family housing investments in recent years. This is driven by the rise in international capital and a changing capital base. In the Baltics, interest in the multi-family housing and private rented sector (PRS) market has grown in the past few years, as real estate investors start to become more comfortable investing into the multi-family, student housing and other sectors which are not the traditional real estate sectors. However, there is a shortage for this type of professionally managed assets in the Baltic region. This sector is at an early development stage;

consequently, investors are making decisions in favour of forward purchases for PRS to be delivered in 3-5 years.

Also, it is worth noting the yields in the PRS are higher than for the same properties in Western and Central Europe, and this is driving an appetite for investing in the region.

There are already a few established investors in the Baltic region who have stepped into the sector, for example local investment funds (such as EfTEN Capital), as well as institutional investors and insurance companies (LHV bank, VIG Fund/BTA Baltic Insurance Company). In addition, several new market players are expected to step in or expand within the CEE and Baltic region in the short term, as further institutional quality schemes become available.

The hotel sector has noticed perhaps the most drastic demand change since the previous financial crisis. Currently, it is not the money-flow, but rather the mobility issue which intuitively implies that hotel cash flows may not necessarily attract significant investment interest. However, investors with a longer time horizon may spot the market opportunity to acquire hotel assets with the high likelihood of soaring demand. Although business trips will probably be replaced by online meetings for quite a while now, tourism is expected to outperform the expectation, judging from the summers of 2020 and 2021. Throughout the Baltic states, the hotel investment has remained relatively active and constituted a total of more than EUR

56mln, which is 11% of the total investment volume in the Baltics.

The most significant transaction within the hospitality in the Baltics was noted in Latvia where an upscale *Mercurie Riga centre* hotel with 143 rooms was sold. In Tallinn also an midscale *Vana-Wiru Hotel (82 rooms)* and luxury *Hotel St. Petersburg (27 rooms)* both changed owners in the first half of 2021. The most significant transaction in Lithuania was observed in the seaside town, Nida, where an upscale almost 4,400 sqm *Nidos Banga Hotel* with 88 rooms was transacted to Reefo.

EUROPEAN INVESTMENT ACTIVITY

Investment volumes in Europe H1 2021 reached EUR 125.6bn, which is a slight decrease (9%), because of record high pre-pandemic investments in Q1 2020. European real estate investment markets showed a rebound in Q2 2021, and according to CBRE’s 2021 EMEA Investor Intentions Survey investors generally hold optimistic views about the investment market and their appetite for acquisitions remains high, with 60% of respondents expecting to increase their purchasing activity in 2021.

Low vacancy rates and strong demand for industrial assets, both impacted by the rise in e-commerce, robust consumer spending and supply chain diversification caused the industrial sector to continue to perform strongly across Europe and the investment volumes increased by 64% in comparison to H1 2020, reaching EUR 25.4bn. With the partial lifting of restrictions, governments re-opening their economies and a return to workplaces, investment into the office sector increased by 37% in Q2 2021 and remains as the most preferred property type amongst European investors. Hotel sector investment volumes have also shown signs of recovery, rising by 9% (y/y) in H1 2021.

The multi-family sector investment volumes in the EMEA region have increased by 50% over the past 5 years. Although the residential half-year investment volumes contracted by 26% y/y, nevertheless the amount of EUR 28.3bn was achieved, with investors still showing interest in the multi-family sector across Europe and as reported by CBRE’s 2021 EMEA Investor Intentions Survey, multi-family was ranked as the second most preferred investment

property type for 2021 and for a quarter of respondents it was the most preferred asset class.

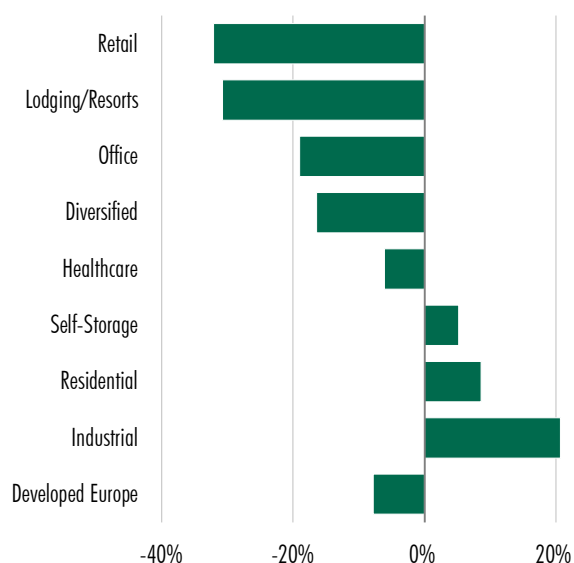
As reported by EPRA, based on cumulative returns in Developed Europe on 30 June 2021 (since February 2020), industrial, residential, and self-storage are the only assets traded above pre-pandemic levels. Self-storage in particular outperformed during H1 2021 and provided the highest YTD return (24.5%).

Figure 9: Prime Yields in the Baltics

Property Type	Country	2020, H1 %	2021, H1 %	Change, p.p.
Shopping centres	Estonia	7	7	0
	Latvia	7.25	7.25	0
	Lithuania	7	6.5	-0.5
Supermarkets	Estonia	6.5	6.25	-0.25
	Latvia	6.5	6.5	0
	Lithuania	6.5	6.5	0
Offices	Estonia	6.15	5.5	-0.65
	Latvia	6.25	5.5	-0.25
	Lithuania	5.85	5.5	-0.35
Logistics	Estonia	7.25	7	-0.25
	Latvia	7.25	7	-0.25
	Lithuania	7.25	6.75	-0.5
Multi-family	Estonia	-	5.25	-
	Latvia	-	5.25	-
	Lithuania	-	5.25	-

Source: CBRE Baltics, 2021.

Figure 10: Total Return by Sector on 30 June 2021 (Since 19/02/2020)



Source: EPRA, Data is compiled from FEN index series, 2021.

RESEARCH DEFINITIONS

Investment Volume – the total amount in value of investment transactions that have completed during the period reported. A property is deemed to be sold only when contracts are signed or a binding agreement exists.

Yield – represents the income return on an investment after operational costs have been deducted. Yield is determined by first subtracting the property's annual operational costs from its gross operating income and then dividing this by a sum of the purchase price (PP), not including additional acquisition costs.

Prime Yield – the yield which an investor would receive when acquiring a grade/class A building in a prime location (CBD, for example), which is fully let at current market value rents. Prime Yield should reflect the level at which relevant transactions are being completed in the market at the time but need not be exactly identical to any of them, particularly if deal flow is very limited or made up of unusual one-off deals. If there are no relevant transactions during the survey period a hypothetical yield is quoted, and is not a calculation based on particular transactions, but it is an expert opinion formed in the light of market conditions, but the same criteria on building location and specification still apply.

Sale and leaseback – a transaction in which the owner of a property sells an asset and then leases it back from the buyer.

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