COMMERCIAL PROPERTY MARKET REPORT

2016
We would like to bring to your attention the latest Commercial Property Market Report prepared by Kivi Real Estate. It summarises information on the main events and trends in the principal commercial space segments in 2015 – office, warehouse and industrial space letting transactions, as well as investment transactions. As is customary, the report looks at the dynamics of rent rates, vacancy rates, the key supply and demand indicators, and major changes in the Riga commercial space rental market in 2015.

We are pleased to let you know that this time, in addition to a focused outline of the developments, we have complemented our report with subject matter expert comments provided exclusively to Kivi Real Estate Report. They include engaging opinions – evaluation and conclusions about 2015, as well as recommendations and forecasts regarding 2016 – of a number of experts representing industries related to the real estate industry.

In 2015, the commercial property rental market was sound in all segments and brought no major surprises. Greater changes are expected from 2017 onwards, when new buildings will appear on the market. The relatively slow but stable rental market has added a persuasive feeling about the Latvian commercial space market, resulting in increased investments.

In recent years, the supply of new offices in Riga has been significantly lower than in Vilnius and Tallinn. Consequently, Latvia has been losing the opportunity of attracting international businesses willing to open their outsourcing centres in Latvia. We therefore appreciate the launching of the construction of the office building Place Eleven by the developer Hanner in the absence of signed preliminary lease agreements. It could serve as the much required evidence for all market participants to regain confidence to – for developers and financiers – that construction and renting of buildings achieving sufficient return on investments is possible, and to tenants – that new office projects exist not only on paper.

Investments made in commercial properties in Latvia over the last year prove that the Latvian market remains attractive for international as well as local investors. The completed transactions suggest that investors are not willing to take risks and prefer making investments into safe assets with consistent long-term tenants, accepting lower returns. Conversely, demand for riskier assets declined last year.

We hope that this Market Report will be thought provoking as well as useful, and it will help make the right decisions in connection with the changes or the choice of appropriate spaces considered for renting or buying.

We are inspired and motivated for new achievements by the success of our loyal long-standing clients as well as of the prospective clients of Kivi Real Estate. The successfully completed transactions prove that we share our common value – quality. We are convinced that 2016 will be the year of active and purposeful work and persuasive results.
OFFICE SPACE MARKET REVIEW

During 2015, no unexpected developments occurred in the office space market in Riga. Throughout the year, the tenant turnover remained moderate. Companies have been after good and top quality space offerings that provide easy access to the facilities, an efficient layout thereof and parking lots nearby. IT companies, as well as various consultancy and service companies have driven the demand most. Offices in Riga are demanded by local companies that are either expanding their business or have decided to move to another space for various reasons, as well as by overseas companies that considering various factors choose the capital of Latvia for opening, for example, their European outsourcing services centre.

DEMAND

At the end of 2015 and beginning of 2016, interest in new office spaces has grown among tenants. However, tenant turnover is not high, given the lack of suitable premises as well as the desire of businesses to expand within existing buildings as far as practicable.

In the centre of Riga, the greatest demand for top quality office spaces comes from law firms, financial services, advertising and public relations companies, as well as small IT industry businesses.

There has been an increase in demand for industrial, creative, modern premises with a novel design and layout. Tenants are interested in finding home in renovated former factory buildings and locations with good public transport access. While previously, such trends were observed among architect, designer and advertising agencies, at present, consulting, translation and programming companies are increasingly following the trend.

There has been a steady demand for good quality, customisable layout spaces, with a convenient location available at favourable rent rates and running costs. There has been constant interest in premises in the city centre, as well as in new or reconstructed projects.

Throughout the year, overseas companies have been interested in large area office spaces; however, the number of closed transactions is affected by the lack of top quality premises that are located conveniently.

Most of the demand for premises in class A and B office buildings comes from companies that require spaces of 150 – 200 m². Office space is also actively searched for by companies considering relocating to a better place or an office with a better layout, with an area between 1,000 m² to 3,000 m².

The demand for offices providing high comfort for employees has been growing. Increased attention is paid to climate control in office premises, as well as to an efficient space configuration, energy efficiency, openable windows and other similar aspects. Businesses are increasingly focusing on the conditions promoting employee productivity, such as ergonomic furniture, equipped kitchenettes and lounges, catering places within the building or nearby, gym facilities, and other service providers.

SUPPLY

During 2015, 3,000 m² of office spaces were added to the class A and B office market in Riga, the total stock reaching approximately 600,000 m² at the beginning of 2016. Of these, 369,000 m² (62%) were speculative developments, whereas 231,000 m² (38%) were built-to-suit developments.
At the beginning of 2016, the supply of vacant class A and B office spaces in Riga was approximately 26,000 m².

Vacant office spaces (above 1,000 m²) are still available in a number of the class B and C office buildings, which were previously let to tenants that were renting large areas and which have now moved out to the buildings of their own or to newer office spaces.

For example, office spaces with an area of 1,700 m² are available at Valdo Biroji, as well as spaces of about the same area at Mednieku Street 4. Office spaces of nearly 3,500 m² are available on S. Eizenšteina Street 29 in Mežciems, which previously was home to the IT company Exigen Services. The company C.T.Co. has vacated premises with an area of approx. 2,500 m² on Jūrkalnes Street 15/25. In March, the airline company AirBaltic will vacate the offices thus far rented by it in Helio Biroji. Most likely, some of the vacant spaces in the building on Jeruzalemes Street 1 will be offered for letting following the change in the ownership thereof.

In the second half of 2015, changes in the offer of the Unity Biznessa Centrs emerged, where large office areas became available after Sanitex moved out. The owners of the building Nordic and Baltic Property (NBP) have confirmed that by the end of 2016, this office building will be let out entirely, considering that Nordea banka has started renting an office of 1,000 m² in it and has reserved further 2,000 m². Other office buildings owned by NBP have been fully let out (Astras Biroji and building on Dzelzavas Street 117); the reconstructed building on 13. Janvāra Street has been nearly fully occupied (Premium Medical being the anchor tenant).

While the supply of vacant class A office spaces has declined, customers are interested in the premises of such kind, as supported by their demand as well as the premises let out in the buildings of the banks Citadele and Nordea.

At the beginning of 2016, vacant spaces in Riga accounted for 5.7% and 3.5% in class B and A office buildings, respectively. The percentage of vacant office spaces hit its lowest mark since the start of the crisis. Tenants have occupied most of the top quality office spaces. Over the last few years, there have been no significant additions to the office market in Riga available for renting.

The lack of new, high quality office buildings in Riga has been a barrier for the entry into Latvia for large outsourcing services and call centre companies.

**RENT RATES**

In 2015, rent rates remained at their previous levels. Overall, they remained stable tending to increase for the best class B offices (taking into account insufficient supply, but big enough demand for such kind of premises). Depending on the area of the rented space, actual rent rates for particular transactions may differ from those originally contracted.

At the end of 2015, rent rates hit 13 – 16 EUR/per m² and 9 – 12 EUR/ per m², in class A and class B office buildings, respectively.

In the historic centre of Riga, rent rates in top quality renovated buildings have hit 8 – 12 EUR/ per m².

The filling of vacant spaces in top class buildings, such as Citadeles banka, Alojas Biznessa Centrs and Jupiter Centre suggests that customers are willing to pay higher rent rates (surpassing 13 – 14 EUR/per m²) for quality premises.
Currently, the supply of vacant spaces is being affected by a significant trend of the past year – a number of office buildings have been acquired by fast-growing overseas companies to accommodate their needs. *Triangula Bastions* on 11 Novembra krastmala (approx. 4,500 m²) was acquired by the company *Euro Live Technologies*, whose office is currently situated at Ganību Dambis. The online gaming/programming company *Evolution* has become the owner of the office building *Ziemeļu vārti*, the part of which it is currently using. The owners of another programming company – *Dyninno* – have bought a building on Jeruzalemes Street 1. The insurance company *Compensa Life* has bought the building on Vienības gatves 87H. Whereas the IT company *C.T.Co* has moved out of its premises on Jūrkalnes Street 15/25 to the building of its own in Valdlauči, Ķekava county.

The companies the business of which does not require a presence in the city centre tend to opt for premises farther away from the city centre. This is supported by the fact that during this year, *Astras Biznessa Centrs* in Purviets has almost completely been let out. For example, the IT and consulting services company *Knowledgeprice* has moved from the premises in the city centre to larger premises in this building.

### TENDENCIES IN 2015

Currently, the supply of vacant spaces is being affected by a significant trend of the past year – a number of office buildings have been acquired by fast-growing overseas companies to accommodate their needs. *Triangula Bastions* on 11 Novembra krastmala (approx. 4,500 m²) was acquired by the company *Euro Live Technologies*, whose office is currently situated at Ganību Dambis. The online gaming/programming company *Evolution* has become the owner of the office building *Ziemeļu vārti*, the part of which it is currently using. The owners of another programming company – *Dyninno* – have bought a building on Jeruzalemes Street 1. The insurance company *Compensa Life* has bought the building on Vienības gatves 87H. Whereas the IT company *C.T.Co* has moved out of its premises on Jūrkalnes Street 15/25 to the building of its own in Valdlauči, Ķekava county.

In 2015, several medical industry companies opened new branches, some of them in office buildings. *Premium Medical* has moved to 13. Janvāra Street from the office building on Duntes Street 11. This has been one of the largest lease transactions (840 m²) to have had place last year, same as the opening of a new branch on Brīvības Street 214 (1,130 m²) by another medical industry company – the clinic *Diamed*. Whereas *Orto clinic* opened the branch of its physiotherapy department (433 m²) on Nometņu Street 61 in Āgenskalns. There is now a medical centre located on the second floor on Mednieku Street 4a.

Due to the lack of top quality office spaces, especially those ranging from 1,000 – 3,000 m², as new office building projects appear on the market, tenants are prepared to enter into pre-lease agreements for the renting of the premises. However, when entering into a pre-lease contract, tenants want to be sure that the construction of the building will be completed in time, therefore, tenants opt in favour of the buildings the construction of which is actually started and the completion deadlines whereof are clear. When entering into pre-lease contracts, the reputation of the project developer and its hitherto experience in the development of similar buildings are of particular importance.

### MAJOR OFFICE LEASE TRANSACTIONS IN 2015

<table>
<thead>
<tr>
<th>COMPANY</th>
<th>INDUSTRY</th>
<th>BUILDING, ADDRESS</th>
<th>AREA (M²)</th>
</tr>
</thead>
<tbody>
<tr>
<td><em>Air Baltic</em></td>
<td>Aviation services</td>
<td>Tehnikas Street 3, Mārupe</td>
<td>4,500</td>
</tr>
<tr>
<td><em>Nordea</em></td>
<td>Banking services</td>
<td><em>Unity Biznesa Centrs</em></td>
<td>3,000</td>
</tr>
<tr>
<td><em>Evolution Latvia</em></td>
<td>IT, online gaming</td>
<td><em>Citadele</em></td>
<td>1,200</td>
</tr>
<tr>
<td><em>Diamed</em></td>
<td>Medical assistance</td>
<td>Brīvības gatve 214</td>
<td>1,130</td>
</tr>
<tr>
<td><em>IMG Services</em></td>
<td>Accounting services</td>
<td><em>SWH biroji</em></td>
<td>1,000</td>
</tr>
<tr>
<td><em>Grant Thornton Baltic</em></td>
<td>Accounting services</td>
<td>Blaumaņa Street 22</td>
<td>1,000</td>
</tr>
<tr>
<td><em>Visma Enterprise</em></td>
<td>IT</td>
<td><em>SWH biroji</em></td>
<td>900</td>
</tr>
<tr>
<td><em>Zalaris HR Services Latvia</em></td>
<td>IT, outsourced services centre</td>
<td>Gunāra Astra Street 1C</td>
<td>885</td>
</tr>
<tr>
<td><em>Premium Medical</em></td>
<td>Medical assistance</td>
<td>13. janvāra Street 3</td>
<td>840</td>
</tr>
<tr>
<td><em>Regus Business Centres</em></td>
<td>Letting of fitted offices</td>
<td>Dominante, Dzirnavu Street 57a</td>
<td>746</td>
</tr>
</tbody>
</table>

*Visma Enterprise* started renting additional office in *SWH biroji* in 2015.
NEW OFFICE BUILDINGS

In 2015, the development of new office buildings started and those already in construction, continued in different parts of Riga. In the newest Hanner office/apartment building on Ropažu Street 10, out of the existing 3,500 m² of office spaces, more than 80% have been let out before being put into service (major tenants being Big Bank and Ingenico). With Mūkusalas Biznesa Centrs expanding, some of its existing tenants consider expanding there, too. An office of 800 m² is still available for letting in the new RBSSkals in Torņakalns on O. Vācieša Street.

Although more new office building projects are planned for 2016, taking into account actual construction opportunities, any significant changes in the supply of new office buildings of new office might be expected from 2017 onwards.

The construction of the Hanner multifunctional class A office building on Sporta Street 11 is carried on actively; it will provide 14,000 m² of space to be let for offices. Works at the development of the project Ropaži 8 (15,000 m² of class A office spaces) are being continued.

The development of the Z-Towers project on Daugavgrīvas Street with the planned class A office space area of 10,000 m² is still in progress. The project New Hanza City project is being developed on Pulkveža Brieža Street 24 with 12,000 m² of class A offices therein. The expansion of the shopping centre Origo is being planned, including 9,000 m² of class B office spaces in the new project. The development of new, top class, modern design office buildings is occurring somewhat slowly because investors are not getting the desired financial returns in this segment.

FORECASTS AND TRENDS FOR 2016

Regardless of the new office areas that are due to be put into service in 2016, the shortage in supply of top quality office spaces will prevail, resulting few vacant spaces. The most significant changes are expected starting from 2017 and 2018.

Rent rates are expected to remain at their current level, and are likely to increase in the office buildings of better quality, offering an easy access and developed infrastructure.

In the light of the shortage of the availability of vacant top quality office spaces, entering into pre-lease contracts for office spaces not yet built is likely to become more popular.

Riga is likely to continue to lose out to other major cities of Eastern Europe in the competition for attracting big, international outsourcing centres as long as the office market is not able to offer adequate spaces.

In 2016, selling of office buildings is likely to persist, and more likely that successful, fast-growing companies will opt to buy buildings for own use rather than rent them, taking into account that an overly large supply of new office spaces is not expected.
In attracting foreign investment, the Investment and Development Agency of Latvia (LIAA) follows the strategy/methodology POLARIS designed to make the process more targeted and efficient. Within the scope of POLARIS, the following eight promising target industries have been identified with a view to providing a focused input to these industries using a proactive as well as a reactive approach: metal processing, mechanical engineering, electronics; timber processing (high value-added sub-sectors); transit and logistics; healthcare; information technology (including global business services); life sciences (pharmaceutical industry and biotechnologies) and green technologies.

Our experience gained in 2015 enables a conclusion that due to the lack of office spaces we are unable to make quality offerings to one of the priority industry segments, i.e., foreign companies seeking to set up shared service centres or business process outsourcing centres in Latvia. The prospects of the availability of such spaces over the next two to three years look grim, too. While in previous years, we were able to boast with the success stories such as the opening of Allnex, Cabot Corporation, and Cytec business centres, there have been no examples of a similar scale for 2015. Largely, this has happened due to the critical lack of appropriate spaces.

Service centres tend to have very specific as well as stringent requirements. The required area must be at least 2,000 m², with the possibility to expand it within the same building within a period of three to five years. Prospective investors are mostly interested in ready spaces and built objects that are in a very good condition (A or B1). They assess the condition of the spaces and the layout (open-space), location and infrastructure thereof. Investors are interested in the city centre, Skanstes and Duntes streets as well as Teika and Mūkusalas street. The representatives of foreign companies, who visit Riga, tend to get the impression that the scale of project development is somewhat unconvincing. Prospective investors are not willing to sign lease agreement for premises which do not exist yet, i.e., for objects being built or in the design stage. When clients turn to LIAA, their objective is to launch the operations of the service centre within the coming six months rather than wait for one year (at best) or two to three years (at worst).

In 2015, there have been cases when investors, who were looking for possible locations for their business, favoured other European cities, e.g., Vilnius, where more of existing class A and class B office buildings are available as well as new such buildings are being constructed. More recently, a global electronics company admitted that it had removed Latvia from its list of options due to the insufficient supply of real estate. It was an unpleasant surprise, indicating that we are unable to provide services to investors who are ready to invest in the sector, which we consider a priority sector, not to mention the carrying out of proactive activities.

In terms of the industry sector, last year same as before, the most active sectors were metal processing, mechanical engineering and electronics, as well as timber processing and green technologies sectors. Production segment investors are more interested in existing facilities and business parks that are suitable for production rather than land plots available for commercial development. As regards lease and purchase options, investors consider mainly good quality spaces rather than Soviet-era factories requiring large extra investments. They are interested in Riga and other port cities such as Liepaja and Ventspils. They find Jelgava attractive, too. Depending on the target market or the availability of raw materials, they are interested in Rēzekne, Aizkraukle, Daugavpils and other cities. Unfortunately, often there is a lack of good quality spaces in this segment, too. Not only the industrial area, but also infrastructure, driveways, electrical power capacity, the availability of gas and the public transport are dissatisfying. In Latvia, there are still quite a large number of areas requiring large investments.
In the light of the above, we would like to encourage developers to continue to work on developing new projects and raising financing. We can see too often that due to the lack of suitable immovable property offers investors might not favour choosing Latvia. This is also the key reason why Riga currently has significant difficulties to compete with Vilnius and other European cities in terms of the opening of service centres. On the bright side, our advantages include availability, the Riga airport, which is the largest airport in the Baltic countries servicing the largest number of flight routes and therefore the largest number of passengers in the Baltic countries. Compared to Scandinavia, we can provide an equal quality of labour expertise and business ethics, while cheaper labour and maintenance costs.

On its website, LIAA has created and has been developing the immovable property database to facilitate to get this information expediently, owing to the importance of this information to potential investors. Every municipality, company or an individual, which manages an immovable property that can be used in business (especially industrial spaces), is called on to submit the relevant information.

As regards forecasting activities in 2016, it must be recognised that the situation is rather unpredictable, because the activities of potential investors are closely related to various factors ranging from global economic fluctuations to geopolitical events. At present, however, we do not see any reason why the interest about Latvia should diminish. No doubt, we are in for positive expectations!

LIAA was founded in 1993 as a non-profit organisation state joint stock company Latvijas Attīstības aģentūra. In 2003, LIAA was reorganised into a state agency The Investment and Development Agency of Latvia, but from 1 January 2013, LIAA is a direct administration institution falling under the supervision of the Ministry of Economics. LIAA offers a broad wide range of services – information on starting up of a business, information on various state aid programs and opportunities to raise financing, provides support to entrepreneurs willing to engage in exporting and looking for cooperation partners abroad. LIAA has evolved into a globally competitive organisation capable of attracting tens of millions of euros in direct foreign investment to Latvia, generating export transactions worth several tens of millions of euros and creating hundreds of new jobs. LIAA has provided support to promote the growth of industrial parks, the setting up of new research laboratories and cooperation in the field of technology transfer.

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INDUSTRIAL PROPERTY MARKET REVIEW

SUPPLY

At the beginning of 2016, the total supply of modern industrial spaces in Riga and nearby areas amounted to approx. 900,000 m², of which 75% were speculative projects, whereas the remaining 25% were built-to-suit projects. In general, the industrial property market increased by approximately 116,000 m² during 2015, whereof 89,000 m² were built-to-suit-projects, whereas 27,000 m² were speculative projects. Of the newly built buildings, 70,800 m² or 61% accounted for spaces to be let as production spaces, whereas those available for letting as warehouse facilities accounted for 45,800 m² or 39% of the total built space. Notably, the support programmes of the Investment and Development Agency of Latvia significantly contributed to the growth of industrial property market in 2015. At least 52% of the total floor space built in 2015 were built with the support of the EU structural fund programmes.

Main additions during the year were as follows: the facilities of Baltic Logistics Solutions of 44,000 m² at Valdlauči, the production facilities of Polipaks NT of 35,000 m² at Mārupe, and production facilities at the NP Biznesa parks of 21,800 m² in Jelgava. The retail company Rimi Baltic has announced it plans investments of EUR 64 million within the coming three years aimed at extending the company’s main warehouse in Riga.

VACANCY AND DEMAND

The geopolitical situation, sanctions imposed against Russia by the Western countries, as well as the economic downturn in Russia and devaluation of the Russian rouble have had an adverse impact on the Latvian freight transport sector. The companies for which the Russian market accounts for a major share of their sales, have taken a “wait-and-see” approach, put their expansion plans on hold or have even reduced the floor space leased by them. At the same time, companies carrying on business on the Latvian or EU markets have not reduced the floor space leased by them; and many, quite contrary, have expanded their floor space or relocated to more modern warehouse facilities.

A couple of large warehouses of 5,000 m² and more account for the most vacancy. Conversely, modern smaller spaces available for letting can be hardly found. An increase in vacancy is related to the uncertain geopolitical situation and the economic downturn in Russia, which has been affecting the transit industry. Owing to the above, at the end of 2015, a number of tenants opted not to renew their lease agreements or optimise their warehouse operations in a single place. Some companies opted to centralise their
warehouse operations in Eastern Europe, relocating their warehouse facilities from Latvia to Poland. It is expected, however, that already in the first half of 2016 the floor space vacated at the end of 2015 will be occupied. As a result, the percentage of vacancy may decline slightly.

From the annual perspective, the percentage of vacancy increased by 1.75 percentage points, and it reached 4.75% in January 2016. In general, the percentage of vacancy will remain higher than in the previous two years. The premises that remain unlet either have high asking rent rates or are unhandy to be adjusted so that they would fit the needs of tenants, or they may have high maintenance costs. Demand for warehouse spaces of above 3,000 m² has declined.

In 2015, compared to the previous after-crisis years, tenant turnover appears to be lower. Amount of premises available for rent is low because of few vacancy (4.75%), consequently options to relocate to more suitable spaces are scarce. Production companies may often require very specific spaces, which landlords are unable to provide, therefore these companies often opt to build or buy buildings for own use. The spaces most demanded in Riga and nearby areas range from 1,000 to 3,000 m². A higher demand can be observed for warehouse facilities, which provide shelving systems, saving relocation or expansion costs for tenants.

### RENT RATES

Despite the low percentage of vacancy, rent rates for industrial spaces have declined by 5-7% compared to 2014. Rent rates have declined for warehouse facilities of over 3,000 m², because the decline in demand on part of tenants was the sharpest in this segment, and only few tenants are able to make use of such areas. The maximum market rent rates referred to in the overview are rarely charged because tenants are lacking sufficient economic justification for relocation.

- Rent rates for class A spaces range from EUR 3.50 to 4.50 per m²;
- Rent rates for class B spaces range from EUR 2.85 to 3.50 per m²

### THE DYNAMICS OF WAREHOUSE RENT RATES (EUR/M²)

<table>
<thead>
<tr>
<th>ADDRESS</th>
<th>INDUSTRY</th>
<th>AREA M²</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maskavas Street 462</td>
<td>Wholesale of auto spare parts</td>
<td>15,000</td>
</tr>
<tr>
<td>Langervaldes Street 2,</td>
<td>Logistics company</td>
<td>10,000</td>
</tr>
<tr>
<td>Jelgava</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dominante park, Ķekava</td>
<td>Logistics company</td>
<td>8,600</td>
</tr>
<tr>
<td>Jaunbūmaņi, Dreiliņi</td>
<td>Wholesale of medical goods</td>
<td>7,000</td>
</tr>
<tr>
<td>Jaunbūmaņi, Dreiliņi</td>
<td>Food plant</td>
<td>6,000</td>
</tr>
<tr>
<td>Loģistikas centrs Berģi</td>
<td>Logistics company</td>
<td>5,000</td>
</tr>
<tr>
<td>Kurzemes prospekts 3</td>
<td>Furniture fittings</td>
<td>4,300</td>
</tr>
<tr>
<td>Business park Abava</td>
<td>Furniture plant</td>
<td>4,000</td>
</tr>
</tbody>
</table>

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Note: The table above lists major industrial space lease transactions in 2015. Although the percentage of vacancy is low, rent rates for industrial spaces have declined by 5-7% compared to 2014.
NEW INDUSTRIAL DEVELOPMENT

Currently, there are projects of new industrial property with the floor space over 200,000 m² in the design state in Riga and nearby areas. However, it is likely that projects with the floor space of not more than 50,000 to 70,000 m² will be implemented over the next two years. In addition, developers may launch such development projects, in respect of which they had managed to sign preliminary contracts with tenants, or such construction projects for which developers will be willing to take on risks and start the construction without entering into preliminary contracts.

New development projects for letting are currently being launched mainly by the developers with a previous experience in developing similar projects, who have bought the land and made investments in the infrastructure, because the development of industrial properties without guaranteed lease agreements are too risky and returns are low. Given the shortage of vacancy of up to 3,000 m², such developers, which will be the first to start the construction of such new projects in the most demanded places or which will be able to offer for letting development projects tailored to the needs of tenants with the implementation term ranging from 12 to 16 months from signing of the contract, will benefit most.

Launching of new projects is also hindered by the availability of bank financing. Mostly, banks are willing to offer partial financing only for construction projects with pre-let space floor and where preliminary lease contracts have been entered into. To attract financing from banks, as well as to reduce the risks thereof, developers require that the prospective tenants should enter into an uncancelable lease agreements, or require the guarantees of a parent company or a bank. Not all companies are capable of obtaining such a guarantee, therefore developers would hardly get engaged in the carrying out construction works prior to entering into lease agreements.

<table>
<thead>
<tr>
<th>ADDRESS</th>
<th>AREA m²</th>
<th>EXPECTED YEAR OF COMMISSION</th>
</tr>
</thead>
<tbody>
<tr>
<td>VGP Park, Ķekava</td>
<td>20,000</td>
<td>Q4 2016</td>
</tr>
<tr>
<td>Noliktavu Street 5, Dreiliņi</td>
<td>18,000</td>
<td>Q3 2016</td>
</tr>
<tr>
<td>Noliktavu Street 2, Dreiliņi</td>
<td>3,500</td>
<td>Q4 2016</td>
</tr>
<tr>
<td>Piedrujas Street 7</td>
<td>5,000</td>
<td>Q4 2016</td>
</tr>
<tr>
<td>Ulbrokas Street 34</td>
<td>5,000</td>
<td>Q4 2016</td>
</tr>
<tr>
<td>Daugavgrīvas Street 77</td>
<td>3,700</td>
<td>Q2 2016</td>
</tr>
<tr>
<td>Plieņciema Street 33</td>
<td>2,500</td>
<td>Q2 2016</td>
</tr>
</tbody>
</table>

TRENDS AND FORECASTS FOR 2016

- Rent rates will remain unchanged, although they are expected to decrease for warehouse with floor space of over 3,000 m².
- The percentage of vacancy will increase slightly, reaching 5% during the year.
- Demand for modern warehouse and production floor space of up to 3,000 m² will remain high.
- Due to the lack of suitable spaces available for letting, production companies will buy or build their own buildings.
- In subsequent years, the supply of modern industrial spaces will continue to grow by 40,000-60,000 m² annually.
In 2015, Economic Growth was Slow But Better Than Expected. This Trend Will Continue Into 2016

The year 2015 was met by economic analysts in Latvia with concern - the steep fall in oil prices in the second half of 2014 along with the Western sanctions imposed on Russia (as well as response sanctions imposed by Russia on the European Union food producers) had set low growth expectations for the Latvian economy. Most analysts forecast declining production volumes and thought that domestic consumption would increase only if the government succeeded in implementing the programmes of the new EU Structural Fund programming period and “launched” the new funds as quickly as practicable.

The outcome was in many ways better than planned. Falling oil prices on global markets affected the prices of all exchange-traded commodity prices; oil prices took a downward turn at an amazing speed. The prices of food, metals, coal, and all kinds of energy resources declined, which significantly affected the prices of other commodities. In fact, there was deflation in Latvia for several months. The total inflation was 0.3% (however, had the government not increased the excise tax on alcohol from 1 July, the inflation would have been replaced by deflation).

Prices not rising had a significant impact on economic growth. Employment growth came to a halt, whereas the wages of the employed continued to grow. Under low economic growth circumstances, this meant declining labour productivity and competitiveness.

The key to economic growth was how quickly Latvian producers would be able to refocus to other markets and how Latvian exports would develop. Latvian businesses proved to be extremely capable. Compared to quite a substantial fall in Estonia and Lithuania’s exports, Latvia’s exports increased by 1.2%, which in combination with the decline in imports (mainly due to the declining prices of energy resources), contributed to Latvia’s economic growth by approx. 3% per annum.

The volume of exports of services also continued to grow, despite that the volume of the major category of exports of services, i.e., transit services, had declined. The volume of other services that can be exported (finance, information technology, carriage by air, advisory services) continued to grow, almost reaching a point where the foreign trade deficit would have been balanced off fully.

In the context of the economic growth of Latvia, the biggest concern is labour productivity. The efforts of the government in launching the Structural Funds programmes have clearly failed, investment volumes are very low due to objective factors (such as the uncertainty of economic development in this part of the world) as well as subjective factors (weak legal environment and excessive bureaucratic practices in Latvia), leaving no basis for any increase in labour productivity. This is an area where it is not enough just with an entrepreneurial mindset and agility – the government’s support is necessary, which so far has been lacking.

Generally, the scenario for 2016 might follow along the same lines. The volume of exports of goods will clearly continue to grow because Latvian exporters are diverse; they represent various sectors and operate on different markets. Moreover, they have proved to be able to adapt to market changes easily. Conversely, the volume of exports of services will continue to decline, whereas the volume of intellectual services will increase. This means a significant increase in the economic value added. The declining oil prices will continue to adversely affect imports and prices. It appears that oil prices may remain low for another three to five years.
The wage increase pressure will continue; the majority of the Latvian population will continue to spend most of their extra income to reduce their future liabilities (accelerated repayment of pre-crisis mortgages, etc.) and on current consumption, rather than seek the opportunity to assume new mortgage or other debt obligations. Furthermore, declining population means a decrease in the demand for such assets that are available to a limited extent, first of all, real estate.

For the real estate sector this means low domestic demand for new housing. The government’s intentions to continue the programme to support the purchase of new housing would not have a sufficient impact on the market – simply, the number of potential buyers is too small. Without implementing an active immigration policy (which is not expected, judging from the developments in the political environment), there are no indications pointing to a steep increase in the housing market over the next few years.

Conversely, in the commercial space market, the demand for new production and logistics facilities will continue to grow steadily. Without such growth, a sustainable increase in production volumes and the volumes of export of services would not be possible. No significant increase is expected in the office and shop space market, though.

The only real estate segment, where one can safely forecast an increase in prices, is agricultural land that will continue to attract increasing EU direct payments, which would directly affect the prices of such land.

Juris Pūce, Economist, the former State Secretary of the Ministry of Economics of the Republic of Latvia, lecturer of the study course “Strategic Management” at the University of Latvia, the host of the TV24 programme “Does money grow on trees”, and the host of the SWH broadcast “Pūce is counting along”.

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Despite an increase in retail sales and purchasing power indicators in 2015, the analysis of the closed lease deals on stand-alone retail premises in the centre of Riga leads to the conclusion that in 2015, rent rates declined by as high as 30% compared to the middle of 2014, when they had reached their peak within the past 5 years.

In 2015, the observed decline in rent rates for retail spaces in the centre of Riga was due to a number of factors:

- The growing popularity of shopping centres, due to which less and less people choose to do the shopping in the city centre;
- An increase in online shopping;
- Fewer parking lots and higher parking costs in the city centre;
- People do the shopping abroad;
- Popular international clothing and footwear brands expanding at shopping centres and the lack of such shops on the busy high streets; therefore, people prefer to do the shopping in shopping centres;
- As the economy was recovering after the years of recession, rent rates rose faster than the purchasing power of the population.

To date, the above-mentioned factors have least affected the rent rates of the spaces on the busiest high streets. In the Old Town, these streets include the following streets: Kalķu, Audēju, Valņu and Šķūņu Streets. Whereas in the city centre, such streets are the beginning section of Terbatas Street, Dzirnavu Street near Terbatas Street, as well as Elizabetes Street near Terbatas Street. These streets concentrate a large flow of consumers with relatively high purchasing power.

Less demanded retail spaces in the centre of the city may often serve as a place to start a new kind of business. It can be admitted that the opening of new cafés, shops and various leisure venues as well as the expansion of existing brand networks is taking place quite actively. New unprecedented concepts are being tried out in the city by owners who have already had experience in doing business of some kind.
SUPPLY AND VACANCY

At the end of 2015, vacancy rate on prime high streets of the city centre made up 7%, or a total of approx. 3,300 m².

At the beginning of 2016, the total occupancy rate had improved. In the second half of 2015, spaces, which had been available in the market for a long time, were let.

In 2015 and 2016, new buildings became available; as a result, the total supply of retail space in the centre of Riga is expected to increase by approx. 2,500 m². For example, at the end of 2015, the project Centrus was completed on Dzirnavu Street 81, in addition to apartments offering ground floor commercial spaces of 1,200 m².

In 2015, the reconstruction of the building on the corner of Tērbatas/Ģertrūde Streets was completed, complementing the supply of quality commercial space in the city centre. At present, all the spaces have been let (to a café, a wine shop, a restaurant and a children’s clothes store).

The reconstruction of Berga Bazārs will be completed in the summer of 2016, when commercial, office and showroom spaces to meet various size needs will become available for letting.

In 2015, same as before, the facades of a number of buildings continued to be restored with a view to rendering these retail spaces there more attractive for entrepreneurs as well as customers.

There are spaces on prime high streets in the city centre, which have been vacant for a long time due to asking high rent rates or the layouts thereof not handy for retail trade. Compared to 2014 and 2015, the share of such vacancy has declined.

As the demand for commercial premises in the city centre has been declining, so has the number of street sections, which can be regarded as prime retail spaces.

Landlords with a long-term perspective have become more understanding and are prepared to compromises concerning the terms and conditions of lease agreements as well as in negotiations with prospective and existing tenants.

DEMAND AND TRENDS

• During 2015, demand for retail spaces in the city centre declined in all retailer segments, except in the catering segment. It keeps outperforming the supply of suitable spaces.

• Retail chains place higher requirements on the building, the layout of spaces, display windows, and engineering solutions.

• Demand for spaces remains high from catering companies in prime shopping areas in the city centre. These companies are mostly looking for spaces of 60 to 200 m², preferably with a possibility of setting up a summer terrace. The lack of suitable spaces has been hindering expansion of the existing, successful and popular restaurants brands.

• A relatively high demand is driven by concept shops of various kinds, which mostly offer designer clothes and other goods.

• The largest demand remains for spaces of up to 100 m² in the busiest places of the city centre and the Old Town, such as: Tērbatas, Barona, Kaļķu and Vaļņu Streets, as well as some parts of Elizabetes, Barona, Brīvības, Ģertrūde and Dzirnavu Streets.

• Opting to open a store in the active centre, popular brands have had an increasing focus on the beginning section of Tērbatas Street, aiming to capture a busy and solvent customer flow. A number of medium to high expensive clothing, footwear and accessories shops have been opened in this part of the street over the last few years.

• The prevailing trend is that companies change their strategy and choose to do business only in the premises of shopping centres.

CHANGES IN THE ACTIVE SHOPPING STREETS IN 2015

• In spring, three popular Italian brands (Twin Set, Alberto Guardian, and Marina Rinaldi) opened their shops in the reconstructed building on the corner of Brīvības and Dzirnavu Streets.

• The Latvian fashion brand Amoralle opened a new shop across the mentioned shops at the intersection of Brīvības and Dzirnavu Streets.

• The shop City and beauty salon Andrey Silchenko Hair Salon have been opened at the beginning of Tērbatas Street.

• The fashion brand Nolo has moved its shop from the corner of Barona and Lāčplēša Streets to the shopping centre Galleria Centrs. A large and spacious shop Pasaules optika will open in the former place thereof in the spring of 2016.

• The casino Olympic has moved to the nearby premises on the corner of Barona and Elizabetes Streets.
• The favoured restaurants Riviera and Rossini have also relocated.

• The restaurants VillAmor and Kolekcionārs have opened on Blaumaņa Street, whereas the eatery Ginger has been replaced by Turk Kebab.

• A Hesburger has opened at the intersection of Lāčplēša and Barona Streets.

• In turn, there are additions to the Narvesen trading network in the city centre: one on Brīvības Street 66 and the other on 13. janvāra Street.

• The raw food restaurant Raw Garden has opened a new eatery on Barona Street.

• In August, the popular fast food brand Kentucky Fried Chicken (KFC) opened its first restaurant in Latvia.

• Two catering facilities (Can Can Pica in the Old Town and Cail Cafe at the intersection of Tērbatas and Dzirnavu Streets) have closed. The footwear brand Moreschi has opened its shop in the former premises of Cail Cafe.

• Coffee Inn network cafés, burger diners Burger Story and Street Burger, as well as the Indian cuisine restaurant Singh’s were expanding actively in the city centre and the Old Town in 2015.

• The popular brands Rimi and Statoil have announced their plans to introduce a new concept. At the end of 2015, the fast shopping concept Rimi shop was opened on Grēcinieku Street 22. In February 2016, the first Statoil shopping shop was opened on Vāļņu Street 11.

• Second-hand clothing shops, which used to be located only in suburban areas and remote streets of the city centre, have been increasingly seeking to open new outlets in the city centre. In addition to various other shops of this segment on Barona Street and Čaka Street, Kilomax opened its outlets in two active locations: one on the corner of Brīvības and Ķertrūdes Streets and the other on Vāļņu Street 19 in the Old Town.

RENT RATES

In 2015, rent rates in the city centre declined by 10-30% compared to 2014, thus interrupting the four-year upward trend that had begun in 2011. The declining demand from tenants in prime shopping streets triggered the declining of rent rates for premises on Marijas/A. Čaka Street, Brīvības Street, and Kr. Barona Street.

Declining rent rates in 2015 was no surprise, given that in the previous years, they had grown faster than the purchasing power of the population. Various hitherto popular and favoured shops closed their stand-alone shops to focus on trading in prime shopping centres. Such examples include the long-standing Lithuanian shoe shop ZB Shoes, which was located on the corner of Barona and Blaumaņa Streets, and the LIU JO brand of Italian fashion clothing on the corner of Lāčplēša and Barona Streets.

The difference in rent rates has increased for premises in prime high streets and elsewhere in the centre of Riga. Catering (fast food) companies are prepared to pay higher rent rates for prime locations in the city centre. At present, the declining of rent rates has slowed, stabilising at around EUR 17-20 EUR/m² for the premises in the busy centre of Riga.

Rent rates for retail spaces of up to 75 m² depending on the layout of the premises fall in the price range of EUR 20-50 EUR per m² in the city centre, and in the range of EUR 35-55 per m² in the Old Town.

Rent rates for retail spaces of 75-150 m² fall in the range of EUR 16-25 per m² in the city centre and EUR 20-50 per m² in the Old Town.

Rent rates for retail spaces above 150 m² are in the range of EUR 12-22 per m² in the city centre and EUR 20-50 per m² in the Old Town.

Outside the tourist season, there are lot of vacant spaces in the Old Town. Therefore rent rates there vary during the season and over the remainder of the year.
THE MOST POPULAR SHOPPING CENTRES AND SUPERMARKETS

The year 2015 brought changes in the shopping centre segment. Such as the planning or launching of the reconstruction of existing centres, new tenants taking up the lettings, the changing of the owners of these centres as well as the construction of new large-scale retail spaces. At the end of last year, the transaction for the sale of shopping centres Alfa, Dole and Mols was approved, the new owner thereof is one of the world’s leading alternative asset management companies Blackstone Group LP.

Expanding of the shopping centres Alfa, Spice and Origo is expected to occur in the near future.

In 2015, the shopping centre Domina underwent significant changes in the composition of the tenants thereof and the rotation thereof within the shopping centre, the opening of Italian shops Intimissimi and Calzedonia, as well as some changes in the appearance thereof. Whereas in the shopping centre Olimpia, the first SportsDirect brand shop was opened in Latvia.

The brands entering Latvia have been increasingly selecting shopping centres as places most appropriate for opening of shops.

In 2015, the shops La Perla, Michael Kors, and Imaginarium were opened in the shopping centre Spice. The brands Calzedonia and Intimissimi expanded their network of shops in Riga and can now be found in the shopping centres Riga Plaza and Spice. The shoe shops Skechers and Dune London were opened in the shopping centres Alfa and Galerija Centrs. At the end of the year, the first shop of the Polish brand Kazar was opened in the shopping centre Alfa.

At the end of the year, VP Grupa received a building permit for the construction of the shopping centre Akropole on Maskavas Street 257 in Ķengarags. The opening of this grand 62,000 m² shopping centre is scheduled for 2018, the year in which Latvia will mark its centenary. The shopping centre is expected to host Maxima XXX shop, it will also offer a wide range of leisure activities (the cinema, a skating rink, bowling, etc.). According to the design solutions, one of the historical buildings of the Kuzņecovs Porcelain Factory will undergo full restoration, and will be built in in the middle part of the multifunctional centre.

Euronics shop and Costa Coffee cafe have been opened in the department store Stockmann.

In 2016, the shopping centre Galleria Riga is expected to undergo reconstruction, the list of the tenants thereof will be complemented by new tenants, such as the COS brand shops. Whereas some shops, which were located in Galleria Riga until now, will relocate to stand-alone shops, e.g., the shop Tiger will be located on Dzirnava Street 71.

According to forecasts, the catering sector is to expand in 2016, and new foreign brands are expected to enter the Latvian market. In January, the shop of the sports goods brand 4F was opened in Riga Plaza. The brand plans to open several more shops.

The share of vacancy in prime shopping centres remained very low (1-2%), and rent rates there have remained at the 2014 level or have increased. No major changes are expected until the opening of the shopping centre Akropole and in terms of expanding of the existing shopping centres.

In 2015, small-sized shopping centres were opened, such as the new Rimi brand shops in Zolitude, Mārupe, Āgenskalns, the shopping centre ArcadA at Āgenskalns, and Maxima on Dzirciema Street.

Like in recent years, the specialised supermarket segment has been saturated. This is supported by the availability of the premises formerly used by Depo on Krasta Street 52. Demand and seeking of expansion opportunities is high from furniture and furnishing shops. The largest shop networks have reached a high coverage stage and no longer have been looking for new premises.

Rent rates for such premises range from EUR 6-9 per m².

IKEA may enter the Latvian market according to some sources.

In 2015, the major event in this segment was the opening of the new DEPO shop on Krasta Street 36 and the purchase of land by it for the construction of a new shop on Kurzemes Street 3.
FRANCHISING PROVIDES THE OPPORTUNITY TO BUY GLOBAL BRANDS

The opening or extension of such trading places, which operate under franchise arrangement (the so-called franchisees), can still be observed in the Latvian trading segment. Globally, the large-scale expansion, development and growth of companies through the franchisor-franchisee relationship is very common.

First and foremost, the franchisor should understand whether his interest to enter the Latvian market is sufficiently grounded from a strategic perspective. Most often, franchisors are willing to give it a go with big countries. As a specific target, Latvia would normally be selected after the big countries have been conquered. Generally, franchisors would view Latvia in the context of the Baltic region with the total population of six million. In general, the Baltic region poses many challenges for franchisors, because each Baltic country has different traditions, mentality, culture, language, laws, etc.

In Latvia, franchises are mostly offered by local Latvian companies, such as Dzintars and Stenders. They are followed by the companies based in USA (service companies, car rental companies, restaurants), such as Best Western Hotel, AVIS, Hertz, Subway, and McDonalds, and in Lithuania (catering companies), such as Čili Pica and Charlie Pizza. Interestingly, for example, McDonalds generates the majority of its profits (about 70%) from leasing out its immovable property to franchisees, whereas franchise payments account for the lesser part of its profits (about 30%).

The franchising concept emerged in the USA. It has been accepted and developed in Latvia, and its popularity has been growing steadily. This is supported by the number of companies that offer franchise, as well as by the number of people willing to acquire franchises.

Finding suitable premises is a relatively long and complicated process for franchisees. First, franchisors select a new territory. Thereafter they make the decision whether the premises should be situated in a traditional location (e.g., a shopping centre or a separate trading venue in the active centre) or in a non-traditional strategic location (such as the airport, a station, a port, a customs area, a sports hall, a bookstore, a library, a university, etc.). Franchisors specify the location, the criteria for the premises and, of course, the visual concept.

Considering that various brands have been building a strong demand for locations in class A shopping centres (Spice, Alpha) where the waiting time may take as long as two years, in some cases exceptions can be made concerning the location when opening a franchise.

Brands such as the IKEA brand, which require large spaces, would need to build a building of their own, because suitable existing spaces would not be available. However, the lack of spaces is not that big a barrier to enter the Latvian market compared to insufficient economic justification.

Over the next few years, brands such as Hilton Garden Inn, Pizza Hut, IKEA, and Vapiano might enter the Latvian market. The latter three brands - Pizza Hut, IKEA, Vapiano - already have a presence in Lithuania.

Over the next few years, a new shopping centre Riga Akropole is expected to be opened in Riga, offering spaces to about 200 lessees. At present, the list of the prospective lessees is not yet known, but it can be expected that most of them would be franchisees representing both well-known and unknown franchise brands in Latvia, thus offering the population more diverse shopping opportunities.

The company Francorp is a global leader in the franchise development industry. Since 1976, Francorp has been providing full service franchise development programmes with a view to helping over 10,000 companies to become successful. Francorp has had the most success stories compared to other franchise consultants. Francorp has a presence in the Baltic countries from November 2013.

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INVESTMENT MARKET

In terms of the volume of investments made in commercial properties, 2015 has been the best year since 2007, with investments totalling EUR 375 million.

In 2015, while the most active investors in the Latvian market were the investment funds, which already had a presence in the Baltics, new real estate funds launched their activities, too, engaging in the largest transactions that occurred last year. In the context of the Baltic market, market investors find Riga increasingly interesting after having entered into a considerable number of transactions in Tallinn and Vilnius in recent years, which has led to a decline in the supply of properties that provide the desired level of return to investors. Investment funds drive the high market demand for top quality let commercial spaces with consistent long-term tenants. In 2015, shopping centre sale transactions prevailed, accounting for 75% of total investments, whereas the remaining part consisted mostly of the sale transactions of office buildings.

In 2015, foreign equity companies appeared to be particularly active; they acquired office buildings for their needs.

Private investors (local as well as those from CIS countries) continue to consider a broad range of commercial properties, giving preference to liquid retail spaces on high streets in the centre of Riga as well as in the centres of the “sleeping districts” of Riga, however, the spaces in this segment rarely make it to the market. Generally, private investors finance their purchase transactions entirely by their own funds, without using bank financing.

TRENDS IN DEMAND FOR INVESTMENT PROPERTIES

• Compared to previous years, in 2015 there was a significant decline in demand for commercial properties intended for development and reconstruction, as well as for properties with legal or technical issues;

• There has been a significant decline in the number of transactions entailing residential space development projects;

• Investors are interested in safe and sound properties, they take a more prudent approach in assessing risks and are more pessimistic about the growth of the rental market;

• There has been a significant decline in interest regarding the acquisition of hotels. This has resulted from the saturation of the hotels market in Riga, which has translated into declining returns for investors, as well as from the falling value of the rouble, given that the investors of CIS countries have made most of the investments in hotels in recent years.

When choosing a piece of property for acquisition, primarily the location and technical condition of the building as well as the composition of tenants are assessed. There has been an increased activity from private local equity investors aiming to buy commercial properties worth up to EUR 1 million. The activity can be explained by the consistency of the commercial property market, greater financial returns compared to alternative types of investments, as well as the availability of bank financing for the
stable and solvent clients. Investors are willing to invest their capital, additionally attracting around 60-70% of bank financing, which enables entering into larger transactions, reduce risks and increase return on equity.

In 2015, the level of returns expected by investors was from 9% - for industrial properties, 7.75% - for office spaces, and 7.25% - for shopping centres, supermarkets and prime retail locations.

**SUPPLY OF INVESTMENT PROPERTIES**

- The supply of investment objects that satisfy market conditions is scarce. Sellers are not willing to sell their property at prices offered by buyers due to the lack of any alternative investment plans and credit obligations requiring urgent repayment;
- Despite the generally large supply of investment objects in the market, sales are often somewhat slow because the prices do not reflect market conditions;
- The lowest supply can be observed in the segment of shopping centres and prime trading spaces as these are the most liquid objects in the lettings market;
- The largest supply is accounted for by old industrial objects, unreconstructed office complexes, and properties of other types requiring large capital outlays before they can be used fully as well as professional experience to develop them successfully.

**KEY EVENTS AND TRENDS IN PURCHASING TRANSACTIONS IN 2015**

The sale of the shopping centres *Alfa, Mols* and *Dole* to the US investment company *Blackstone Group* was the largest transaction in the shopping centre segment. These shopping centres in Riga were acquired as part of a larger transaction, within the scope of which a real estate portfolio in several countries was acquired.

The Swiss investment company *Partners Group* acquired the shopping centre *Olimpia* within the scope of acquiring a real estate portfolio.

The Maltese company *Hili Properties* acquired the shopping centre portfolio managed by *R.B. Management*, consisting of nine properties in Riga, Tukums, Aizkraukle, and Daugavpils.

Whereas the Estonian investment company *Colonna Capital* acquired a real estate portfolio consisting of 12 buildings, the key tenant of which is the food retailer *Supernetto*.

Several not so large transactions were also carried out, entailing the acquisition of one or two shopping centres.

Compared to 2014, last year there was a large number of office building acquisition transactions.

### TOP INVESTMENT DEALS IN LATVIA IN 2015

<table>
<thead>
<tr>
<th>NAME OF THE PROPERTY</th>
<th>ADDRESS OF THE PROPERTY</th>
<th>TYPE OF PROPERTY</th>
<th>BUYER</th>
</tr>
</thead>
<tbody>
<tr>
<td>S/C portfolio <em>Dole, Alfa, Mols</em></td>
<td>Riga</td>
<td>Trading spaces</td>
<td><em>Blackstone Real Estate Partners IV</em></td>
</tr>
<tr>
<td><em>Duntes biroji</em></td>
<td>Duntes Street 6</td>
<td>Offices</td>
<td><em>EFTEN Capital</em></td>
</tr>
<tr>
<td><em>S/C Olimpia</em></td>
<td>Āzenes Street 5</td>
<td>Trading spaces</td>
<td><em>Partners Group</em></td>
</tr>
<tr>
<td>S/C portfolio, Riga, Tukums, Daugavpils, Aizkraukle</td>
<td>Riga and other Latvian cities</td>
<td>Trading spaces</td>
<td><em>Hili Properties</em></td>
</tr>
<tr>
<td>Office building, Alunāna Street 2</td>
<td>Alunāna Street 2</td>
<td>Offices</td>
<td><em>Reģionālā Investīciju Banka</em></td>
</tr>
<tr>
<td>O/C &quot;Ziemeļu Vārti&quot;</td>
<td>Brīvības Street 149/151</td>
<td>Offices</td>
<td><em>Evolution Gaming</em></td>
</tr>
<tr>
<td><em>Supernetto shop portfolio, 12 buildings</em></td>
<td>Riga and other Latvian cities</td>
<td>Trading spaces</td>
<td><em>Colonna Capital</em></td>
</tr>
<tr>
<td>O/C <em>Triangula bastions</em></td>
<td>11.novembra krastmala 13</td>
<td>Offices</td>
<td><em>Eiro Live Technologies</em></td>
</tr>
<tr>
<td>Office building on Brīvības Street 21</td>
<td>Brīvības Street 21</td>
<td>Offices/Trading spaces</td>
<td><em>Baltic RE Group</em></td>
</tr>
</tbody>
</table>
Moreover, several of them were acquired for own use by fast growing and highly successful companies. Among the purchased objects there were class B office buildings as well as buildings requiring the adjusting thereof to accommodate the needs of an office. The buyers who are end-users are predominantly foreign equity companies engaged in provision of information technology and outsourced services. The decision in favour of the purchase of an own building is mainly determined by the company’s rapid growth, the need for regular expansion, and the office space occupied thus far of at least 2,000 m².

The Internet gambling company Evolution Gaming acquired the office building Ziemeļu vārti for its needs, whereas the company belonging to the same industry Euro Live Technologies acquired the complex Triangula Bastions on 11 Novembra Krastmala. In turn, the technology company Dyninno acquired an office building on Jeruzalemes Street 1. Reģionālā Investīciju Banka has also acquired a building for its needs (on Alunāna Street 2), same as the insurance company Compensa (on Vienības gatve 87h).

Last year, Estonian investment company EITEN Capital continued investing in commercial properties in Latvia, acquiring two office buildings (Duntes biroji and Lāčplēša 20a).

2015 was a somewhat less active year in logistics and industrial space sale markets, the largest transaction being the sale of the warehouse complex on Ulbrokas Street 38 to local investors.

**FORECASTS FOR 2016**

- The total volume of investments in 2016 is forecast to remain at the 2015 level or slightly lower. Like in 2015, investments in shopping centres will account for the major part of the total volume of investments, whereas half of the total volume of investments could be made up by a few large transactions;

- According to the information at the disposal of Kivi Real Estate, the shareholding of at least two leading shopping centres could change hands in 2016;

- The interest of investors about Latvia will remain high, however, the number of transactions will be limited due to insufficient supply of liquid objects;

- Capitalisation rates for top quality commercial properties will decline, whereas they will rise for poor quality properties;

- Demand for development projects will remain low. The situation is aggravated by the complicated and lengthy process for the approval of technical designs in Riga.
CONSULTING WITH INDUSTRY EXPERTS IS KEY FOR DECISION-MAKING

A slight insight into some of the most important changes in law and trends in the immovable property industry in 2015.

ACQUISITION OF AN IMMOVABLE PROPERTY VS. ACQUISITION OF THE COMPANY OWNING THE IMMOVABLE PROPERTY

Where according to the Land Register the owner of a commercial property is a commercial company (we will particularly look at the capital company), the law firm PricewaterhouseCoopers Legal (“PwC Legal”) is often inquired about which of the options – buying the immovable property or buying the company owning it – is more advantageous. Here we offer a brief overview of some of the most noticeable differences, because each acquisition of a commercial property should be assessed on a case-by-case basis, and there is no single “one-fits-all” solution.

ACQUISITION OF IMMOVABLE PROPERTY

Pros:
• A clearly defined subject of the transaction, i.e., a specific immovable property is being bought. The buyer is aware of the publicly registered liens and pledge rights;
• There is no transfer of contractual obligations assumed by the company, except those expressly taken over by the buyer;
• The raising of the funding, if such is necessary for the acquisition of the immovable property, may be relatively easier.

Cons:
• The buyer or the seller is required to pay a stamp duty of 2% on the transaction amount or cadastral value, whichever is higher, for the re-registration of the ownership title in the Land Register. The stamp duty is capped at EUR 42,686.15 (if the immovable property consists of only a commercial building or commercial buildings and the civil engineering constructions related thereto);
• If the seller of the property is a Latvian company, it would be subject to corporate income tax (CIT) at 15% on the gains. Conversely, if the seller is a natural person, unless the exemptions laid down in the law On Personal Income Tax can be applied, he/she would be subject to capital gains tax at 15% on the difference between the selling price and the purchase cost of the immovable property;
• The registration of the change in the ownership title would take longer – ten (10) days (in complicated cases the Head of the Land Registry Office may extend this term up to one month).

ACQUISITION OF THE COMPANY OWNING THE IMMOVABLE PROPERTY

Pros:
• A relatively low stamp duty is levied on the re-registration of the ownership title to capital shares and the changes in the composition of the company’s management board in the Enterprise Register of the Republic of Latvia (“the ER”);
• Previously concluded contracts may have favourable terms. For example, the concluded lease agreements might be generating stable cash flows, rendering the acquisition of the immovable property more attractive;
• There is no need to re-enter into the previously concluded contracts with the providers of facility management, maintenance, and utility services;
• A fast transaction, i.e., the changes can be registered with the ER within one business day.

Cons:
• When buying the shares of the company, the buyer would typically acquire not only the company but also all the contractual rights and obligations assumed by that company over the time. There is a risk that not all obligations have been identified, which might lead to unplanned expenditures and court proceedings, with the buyer taking care of the assumed obligations;
• Additional expenditure related to the carrying out the company’s legal, financial and tax due diligence.
Thus, if a company owning the immovable property is acquired, the contractual obligations of that company can be both an advantage and a disadvantage.

There is a difference depending on what kind of the company owns the immovable property and what the principal activity of that company is. For example, if the company is not engaged in carrying out general business activities and has been founded to enter into transactions with the immovable property owned by it, including leasing it out, then the assessment procedure will be relatively easier and less costly than if the company’s principal business activity were related not only to real estate.

Usually, the acquisition of a company entails additional costs related to the company’s legal, financial and tax due diligence, unlike in the case when only the immovable property is bought. The financing of the acquisition of the company is also more complicated because the buyer takes over the existing obligations (if applicable) of that company. More likely than not, the approval of the credit institution for the change in the company’s shareholding would need to be obtained.

Quite often, however, the previously concluded financing contracts of the company owning the immovable property have lower interest rates than the market rates available at the time of the acquisition. Moreover, long-term lease agreements may have been concluded with lessees on beneficial terms. These circumstances may warrant for carrying out a relatively more detailed pre-feasibility study of the transaction and choose to buy the company owning the immovable property.

We would therefore like to highlight the importance of bringing in industry professionals to select the best solution in the particular case.

**WHEN DOES THE STAMP DUTY OF 6% BECOME PAYABLE?**

It is only quite recently (from 1 January 2014) that in cases where a legal person carrying out business activities is willing to buy for its purposes an immovable property that qualifies as a residential property, the transaction would be subject to a stamp duty of 6% on the value of that residential property.

Example. A legal person engaged in carrying out business activities is willing to buy an office to be used for its business purposes. The building in which the office is situated has been divided into residential properties, and the registered type of use of the building in which the immovable property to be bought is situated is “a residential building”, and the premises belong to the group of residential premises of the residential building. A similar situation might also apply to the premises used for trading purposes, however, the registered use of which is “residential premises”.

To avoid surprises, prior to closing the deal it should be ascertained what the registered use of that immovable property is.

This information can be verified on the data publishing and e-Services website of the State Land Service www.kadastrs.lv, by viewing the descriptive data of the relevant building and the group of premises, including the breakdown by the kind of use.

*PwC Legal* strongly advises engaging a legal consultant at least at the point when specific immovable property objects have been selected for the evaluation of the acquisition thereof. After the assessment of the existing circumstances, carrying out of the risk analysis and the issuing of the opinion, the prospective buyer would not only be in a better position to make the choice as to which of the immovable properties better meets his objectives; moreover, he would also have the type of acquisition and the structure of the transaction assessed and legal risks identified.

*The main practice areas of PwC Legal are mergers and acquisition, reorganisations, restructuring and insolvency, banking and financial law, real estate and construction, corporate law, tax law, employment law, immigration law, data protection, intellectual property law, competition law, public and private partnership, public and administrative law, dispute resolution, and representation in court.*

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Investments made by the ten members of the National Real Estate Development Alliance (NNIAA) in developing new projects in Riga and its vicinity have reached 1.5 billion euros. This accounts for one fifth of Latvia’s budget and almost one third of the EU Fund financing acquired during the previous period. Whereas taxes paid to the State by the members of NNIAA in connection with the implementation of about 80 real estate projects covering millions of square metres amounted to 77 million euros.

There are few who appreciate the great contribution made by real estate developers to economic development and the overall growth of the national economy. These indicators support that real estate developers are significant investors, whereas the real estate segment is a significant force driving the national economy and a booster for economy.

Despite a gradual growth, the pace and further successful development of the real estate market depends on political decisions. The inconsistency in making them demonstrated by recent governments has had a direct impact on the business environment, rendering it less attractive to foreign investors in terms of the Baltic market perspective. Therefore, we do hope that the new government will be much more thoughtful in its decision-making and develop a more rational policy to prevent channelling of investments to the neighbouring countries.

Out of the three Baltic countries, Latvia has been ranking lowest in terms of banking loans. The growth rate of new loans issued to residents is still negative compared to Estonia and Lithuania, where lending was put back on track already two years ago. The lending activity is one of the indicators that can be used to evaluate the level of social and economic activity in Latvia, which also serves as an important indicator to investors when they consider in which Baltic country they should develop their business. It should be noted that attracting investors’ capital is a very important factor for Latvia’s economic development, because the domestic market is too small to ensure the level of the economic development matching that of the prosperous Europe.

Last year, with its plans to apply the “keys left on the table” principle to all mortgage loan agreements, the government nearly managed to “pull down the emergency brake” for lending to residents in Latvia, proving that any ruthless political decision may have an adverse impact on the population’s economic activity and aggravate the business environment.

On the other hand, the initiative of the government to develop a support programme for young families buying their first homes has been a positive development. True, developing this programme any further, the State should take care of promoting state support for the purchase of housing in new projects because nearly 80% of the residential market represent the housing built in the Soviet times and earlier, and the majority of them would require renovating. The experts of the European Bank for Reconstruction and Development have estimated that at least 8 billion euros would need to be raised to restore these buildings only partly. Furthermore, when the State issues guarantees for housing in new projects, it would not take risks because – unlike in cases when property is acquired on the secondary housing market – it would immediately receive the guaranteed amount back from the developer in the form of paid VAT.

From the perspective of the Baltic countries, in order to successfully compete in attracting investments with Lithuania and Estonia, an important challenge is to reduce the term for the approval of new projects. At present, the approval process at the Riga City Construction Board can take between four months up to one and a half years. In this regard, Latvia should strive to achieve the Lithuanian model, where the respective term for the approval of new real estate projects takes up to one month for most of projects. One of the first efforts aimed at the improvement of the business environment should entail the revision of
laws with a view to removing unnecessary bureaucratic practices, as well as to implementing the electronic environment enabling developers to submit projects electronically and thereafter engaging in an easy and fast communication with all responsible authorities.

Long approval periods have lead to a situation where we keep shooting ourselves in the foot with inconsistent decision-making. Each year, we are losing investments that are worth tens of millions of euros, which flow to Lithuania and Estonia in the form of new real estate projects.

The new government is about to start its work, and we would like to believe that it would be capable of making decisions that are aimed at improving a friendly business environment, economic growth and increased competitiveness in the context of the Baltic countries. It is important not to “pull down the emergency brake”, but rather to provide thoughtful support for industry development. NNIAA would like to point out that the development of new projects means ambitious investments in the development of this country and the capital city thereof. Most of them would flow into the Treasury in the form of paid taxes and be directly invested to develop related industries, creating new jobs, as well as to build and optimise infrastructure. It would generally promote the well-being of the country and its population, as well as open up broader opportunities for the State and municipalities to resolve social problems.

The objective of the National Real Estate Development Alliance (NNIA) is to represent the interests of the sector at national and local government level, to ensure sustainable development of the sector and contribute to the general optimisation thereof, as well as to promote the role of real estate developers in the Latvian economy. The founders of NNIAA are SIA Dekarta Property, SIA Domuss, Hanner Group, SIA Merks, AS MCITY Holdings (Modern City), SIA NCC Housing, SIA Ordo Group, SIA Pillar Management, AS Towers Construction Management and YIT Celtniecība.

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