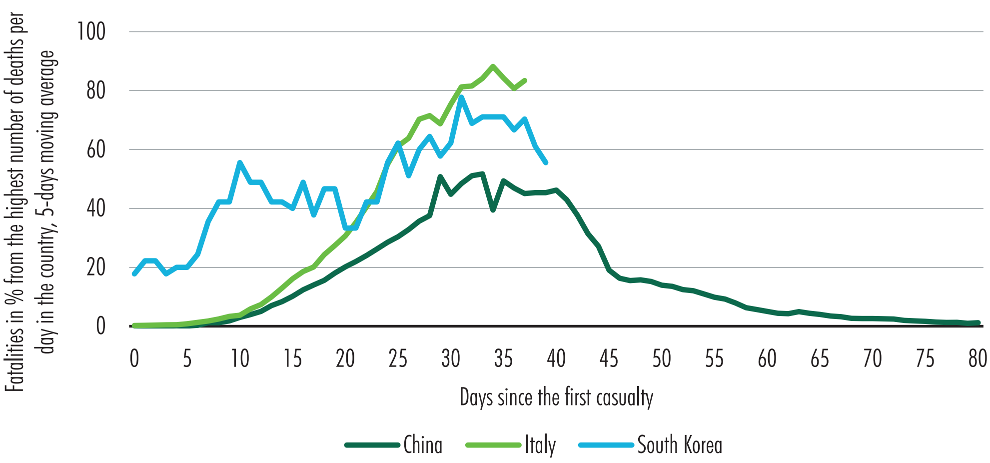
ALL SECTORS, 2020

IMPLICATIONS OF THE CORONAVIRUS ON COMMERCIAL REAL ESTATE IN THE BALTICS

Other countries observed the peak in around 35 day since the first fatal case related to COVID-19



Note: Lithuania 10 days since the first casualty, Estonia – 5 day, Latvia – no casualties, as of 31-03-2020
Source: European Centre for Disease Prevention and Control.

SUMMARY

- The implications will be widespread and will affect all the sectors. Yet, some sectors, like industrial and logistics, will experience milder adverse effects while retail and hospitality will be hit most severely.
- Businesses more exposed to digital economy will have a cushion for an upcoming decline in private consumption
- The global real estate activity is expected to rebound if the outbreak is brought under control in a reasonable timeframe. However, it will likely take more time for the Baltics to recover.
- National governments are announcing substantial fiscal stimulus packages.
- Investors and banks have already adjusted risk profiles for real estate activities.
- Significant delays are expected in development pipelines.
- The office occupier market will experience disruptions, yet activity somewhat may be encouraged by renegotiations and renewals.

GENERAL SITUATION AND POLICY RESPONSE

The impact of the COVID-19 virus is manifested in many sectors of the economy and real estate - most notably within the hospitality and the retail sectors directly, as well as for the remaining sectors via postponed decisions, increased tenant risk profiles and delayed financing.

At a national level, economic policy responses to COVID-19 have been significant. Also, unlike during the 2008 financial crisis, countries are now more prepared to withstand a strong blow to their economies. Public finances are much more balanced, with private savings at an all time high and debt markets more familiar with the countries and willing to lend.

In Lithuania, the government has approved a EUR 2.5 bln (ca. 5% of GDP) fiscal stimulus package, that includes additional spending for health sectors, social security payments, delays in mortgage payments for those who have lost employment, business support (e.g. liquidity increase), additional investment spending (e.g. renovation of old apartment buildings), etc. The states' borrowing cap was lifted from EUR 0.9 bln to EUR 5.4 bln, allowing for an increase in finances to fight the economic consequences of the pandemic. In addition, the central bank has reduced capital requirements for banks, which has enabled EUR 2.0 bln of additional lending.

In Latvia, government support worth EUR 1.1 bln (ca 3.3% of GDP) was approved. Another EUR 1.0 bln have been earmarked in the form of various financial instruments, e.g. an agreement concluded with the European Investment Bank (EIB) that allows Latvia to access EUR 400 mln to deal with the consequences of the COVID-19 crisis. Also, EUR 600 mln are available from EU funds to help the hardest-hit sectors of the economy. The package includes loan guarantees for credit payments, export guarantees, tax breaks, adjustments to the social benefits, medical staff premiums' payments. In total, Latvia's government has increased the support budget ceiling to over EUR 2.0 bln – 6.7% of GDP.

In Estonia, EUR 2.0 bln or nearly 7% of GDP has been set aside in economic measures to alleviate the early stages of the crisis. The measures are targeted at decreasing the number of bankruptcies and returning the economy to a growth path as soon as possible. The package includes loan guarantee for existing loans, revolving loans, investment loans, mitigation measures of unemployment.

Unlike during the 2008 financial crisis, the countries are more prepared to withstand a strong blow to their economies

To fight the spread of the New Coronavirus, the governments have established partial quarantine measures. Since the 16th March, most of the public institutions have been closed, or the work is limited. Most operations in other public places have also ceased or are restricted. The measures slightly differ by country, e.g. Lithuania has enforced closure of all non-essential retailers, with the exception of groceries, pharmacies, vet pharmacies, optical stores, markets. Restaurants may serve only take-away clients. In Latvia and Estonia, the measures are slightly more relaxed, as shops and bars are allowed to operate but it is required to keep distances among the clients. Across all three countries, international travelling is strictly limited. Only returning citizens are allowed to enter the countries.

IMPLICATIONS FOR COMMERCIAL REAL ESTATE

Before the pandemic broke out, broadly, all real estate sectors across all three states were performing rather strongly and growing rapidly. There were considerable investment and development activities in all sectors, which was accompanied by decreasing yields. The supply and announced pipelines beat records for several years in a row. However, occupier demand was strong, vacancy low, and rents and yields were either stable or improving.

CBRE Baltics expects COVID-19 to have a strong negative short-to-medium-term effect on the commercial real estate market in the Baltics, provided the outbreak is brought under control in a reasonable timeframe. The necessary measures taken to stop the spread of the virus will have a brutal direct effect on some sectors in the short term. The implemented actions overnight erased the revenues of many physical retailers, restaurants, and hotels, with some enterprises observing their turnover drop to zero

Some sectors will experience only mitigated results of the virus caused disruption. For example, supermarkets are experiencing mild restrictions and a decrease in sensible customer visits. Yet, flows are counterbalanced by an increase in spending on essential goods that some concerned buyers are stockpiling. Overall, the impact by sector can be summarised in the following paragraphs.

THE INVESTMENT MARKET

The Baltics have experienced a record high EUR 1.2 bln investment volume for two consecutive years, which is unlikely to be repeated in 2020. Transaction volumes for the year are now likely to be considerably lower than last year not only due to disruption in everyday operations, such as face-to-face meetings and travel restrictions, but also due to risk profile adjustments by investors and banks. Some investors have already sensed an opportunity to negotiate lower prices. The yield expectations have increased by up to 0.25% for some premium assets and even more for secondary assets. What is more important, especially for local investors, is that local banks have changed their conditions for real estate development and acquisitions and frozen financing for certain sectors (e.g. hospitality). Swift changes in loan interests and LTV ratios offered will mean that operations will cease until investors adapt their business plans.

Economic stimuli across the globe provides encouragement that transaction activity will recover when the pandemic retreats. However, the Baltics are regarded as peripheral on the continental investors’ and financiers’ map. Thus, it is unlikely for a return to activity in the region, when there will be newly opened opportunities to exploit in the core markets. Low diversification of financing sources could prevent exploiting low cost of financing caused by economic stimuli around the World.

DEVELOPMENT MARKET

The actual labour market within the construction industry has not been affected much yet, and many are speculating on how it will play out in the next few months if further quarantine measures are imposed. The sector has experienced some challenges due to disruptions in the supply chain. However, the biggest challenge is failure to attract new tenants on time, as well as possible financing issues. It will force many developers to delay delivery times of projects in the pipeline. Some developers are already talking about moving project commissioning times. There are also cases where financing has been revoked. Consequently, it is expected that many more developers will follow by postponing the launch of projects.

THE OFFICE OCCUPIER MARKET

From an office occupational viewpoint, activity is continuing, with advanced transactions still proceeding, but, inevitably, some leasing decisions will now be put on hold. We are not anticipating a significant decline in demand for offices, albeit some occupiers with existing requirements might push out decision-making with some transactions that were expected to complete at risk of being delayed as a result.

Most businesses are currently more focused on immediate business continuity than longer-term occupancy decisions. At the same time, recent stock market corrections will lead many companies to adopt a more cautious approach to expansion and relocation decisions for the foreseeable future. A minor decrease in market activity from both international and local clients was observed even before the quarantine. Due to concerns regarding travelling, site visits, and face to face meetings, most of the transactions are unlikely to proceed, so it is anticipated that the timeline for any project will now shift.

CBRE Baltics expects occupier activity to bounce when it is safe to operate. However, this does not necessarily mean good news for landlords. The reasoning being that some occupiers who have already foreseen & planned certain activities, must either renew the current lease agreements or relocate. Others will move closer in their decision-making either by wanting to use a convenient time for expansion planned in the next year or by seeking to reduce rents / cut costs by giving up space due to decreased business activities. In addition, we will observe more activity in trying to optimize space, for example, sublease deals with companies which are locked in to their lease agreements. Once the worst is over, demand for flexible offices should grow. Projects developed in stages will have an upper hand because they are able to offer more flexible solutions. However, office space optimization could be a problem in older office buildings as they are less adaptable, and this space may need to be reconfigured.

LOGISTICS

The logistics sector is probably the one that will experience the most mitigated negative consequences of the pandemic caused economic disruption. In the short-term, the sector may even experience an opposite effect caused by an increase spending on food and necessities as consumers prepare for supply disruptions during the quarantine period. Besides, an increase in online retailing and courier services will keep warehouses busy and reduce the negative impact at least to a certain degree. On the other hand some, the impacts are becoming visible on certain production and discretionary goods warehouse facilities.

In the medium and long term, the economic slowdown and the resulting decline in private consumption should catch up on the sector as well. However, CBRE Baltics are not anticipating a significant decline in demand for industrial and logistics properties, albeit that some occupiers might push out decision-making until uncertainty diminishes.

RETAIL

The retail sector is one that has been very visibly impacted, as quarantine measures have cut off or significantly reduced most operations. The ones that had an online presence, had existing contracts with online distributors, or were able to move their operations using e-commerce solutions quickly will have some kind of cushion to survive the quarantine period. Also, retailers are widely negotiating rent reductions and rent free periods in order to minimize operational costs. Otherwise, outside of grocery stores and pharmacies, a considerable number of retailers and restaurants may be forced to close their businesses indefinitely, unless state support will be able to alleviate pressure significantly. Eventually, vacancy in the retail sector will increase with no quick recovery.

Similarly, the hospitality sector is very severely affected due to travel restrictions. Some smaller enterprises were able to exploit the situation by offering services for self-isolation to citizens returning from abroad. Yet it is clear that such solutions will not save the sector.

Short term brutal, but medium term positive

– Richard Barkham, Ph.D., Global Chief Economist & Head of Americas Research on global economic outlook affected by the New coronavirus

OUTLOOK

The Baltic countries are in the relatively early stages of the COVID-19 outbreak compared to Southern European countries, and especially China, which already shows signs of recovery. The adverse economic and humanitarian effects are yet to peak.

The crisis has provided a push for broad adaptation and use of e-solutions, which will be more available and exploited whether it is e-governance in the public sector, e-commerce in business, on-line learning in educational institutions etc., - all a sign of a massive change of habits and tools. The habit of “staying home” to a certain extent will remain or at least will be more popular than before the pandemic. This will fuel logistics and on-line platforms across a broad spectrum. Psychological restrictions concerning crowds and cross border travel are likely to keep having an impact on behavior in the medium term. As a consequence domestic tourism and secondary city hospitality business, including retail and services, might well grow after pandemic.

Investors are likely to go for more security. That means more focus on multifamily and logistics, followed by offices. Retail, hotels and operational real estate is likely to see a drop in investment demand in the foreseeable future.

CONTACTS

Ignas Gostautas, PhD
Senior Analyst | Research & Consulting
M +370 694 88318
ignas.gostautas@cbre.lt

OFFICES

Riga Plaza
Mukusalas Street 71,
Riga, Latvia, LV-1004

Green Hall 2
Upes Street 23,
Vilnius, Lithuania, LT-08128

UMA Maakri
4. korrus, Maakri 19-1,
Tallinn, Estonia, EE-10145

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