MARKETVIEW
TALLINN OFFICES, H1 2021

CBRE Baltics
Part of the CBRE affiliate Network

Hybrid workplace the new normal

Office Stock **907,000 sqm** ▲ | Completions **22,600 sqm** ▲ | Vacancy **6-7%** ▲ | Prime Yield **5.5%** ▼

*Arrows indicate change from the H1 2020

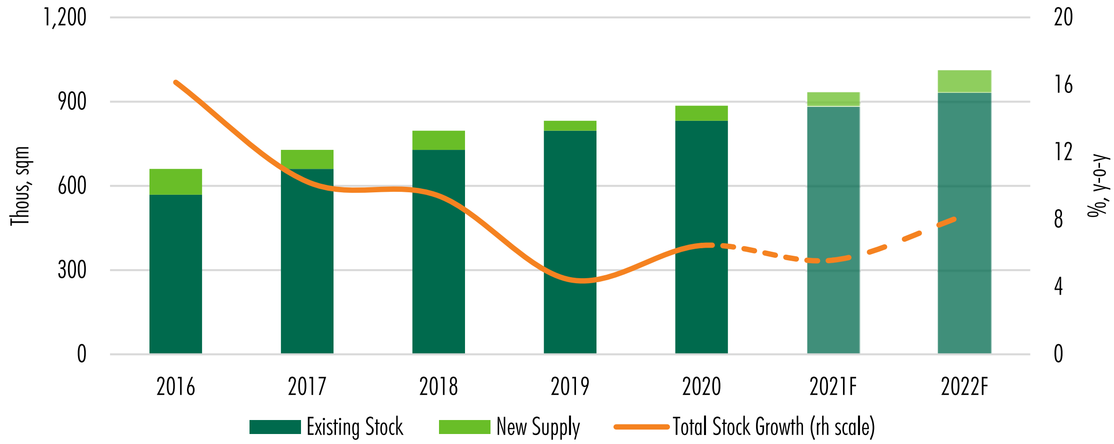
Picture 1: Electra by Kaamos– one of the most sizeable office projects in H1 2021

Source: Kaamos, 2021.

KEY POINTS

- The first half of 2021 brought two modern office projects that added 22,000 sqm to the total Tallinn office market, double the amount than in the same period last year.
- 30,000 sqm of new modern office space is expected to be delivered by the end of the year, bringing the total stock to 950,000 sqm.
- Currently, A-class offices constitute 41%, while the remaining 59% of total stock is made up of B-class.
- The office vacancy stands at 6.2%, which is more than a 0.2 % increase compared to the same time a year ago. The A-class office vacancy is expected to remain the same, while B-class vacancy levels will slightly increase.
- Rental levels remain the same, for B-class office premises at between 12.0 – 14.0 EUR/sqm/month, while for a typical A-class office levels are between 15.0 – 17.0 EUR/sqm/month.
- Since landlords are expecting a further increase in value, there were no substantial office investments in H1 2021. According to the data available to us, we estimate that the prime yield has compressed by 50 bp and currently stands at around 5.5 %
- The hybrid office solution is expected to be the new normal, where employees divide their working hours between their office and home.

Figure 1: Modern stock, new supply and stock growth rate 2016 – 2020 with forecast for 2021F-2022F



Note: the end of the indicated year. Forecast is based on announced completion dates of the planned projects.
Source: CBRE Baltics, 2021.

ECONOMIC OUTLOOK

In 2020 the economy shrank 2.7%, marking the first downturn in Estonia since the 2009 global financial crisis. In the summer, when restrictions were removed, the economy recovered somewhat, with retail sales and exports rebounding to their 2019 levels. However, it is expected that the economy will probably recover to its pre-crisis level by 2022.

GDP is seen as rebounding solidly this year, after last year's Covid-19-induced recession, keeping the budget deficit at an elevated level, although Estonia's public debt burden is forecast to remain the lowest in the European Union. Strengthening foreign demand should sustain the external sector, while households and businesses are set to resume spending as the economy reopens and sentiment recovers.

Estonia's public and private sectors are innovative and efficient and foreign investors have remained attracted to Estonia due to its openness, efficient government, strong rule of law and business-friendly environment. Estonia is in the top 20 or top 30 countries around the world in various reputable international indexes of competitiveness, and its position has improved consistently. The country is ranked 18th globally in the World Bank's Doing Business rating.

Estonia's real GDP dropped in 2020, but is set to recover and should return to its 2019 level by the end of 2022. The real GDP per capita in 2020 is estimated at EUR 15,250 by Eurostat, decreasing by 3% compared to 2019. The decline in economic activity was softened by sustained public expenditure and by a large reduction in imports.

As COVID-19 restrictions are assumed to be lifted gradually, Oxford Economics forecast GDP to grow by 3.8% in 2021, with growth expected to strengthen towards the second half of the year. Growth momentum is forecast to drive annual GDP up by 5.7% in 2022. In both years, economic uplift is expected to be driven mainly by private consumption and a gradual resumption of private investment.

SUPPLY

When at the beginning of 2020, the Covid-19 pandemic hit for the first time, many developers were shell shocked, and many yet to be started projects were put on hold. However, with the passing of time and more people getting vaccinated, developers continue with their projects.

In the first half of the year, two new projects were delivered—the most sizeable being the R6 building in the Rotermanni Quarter. Despite the past Covid restrictions, the 11,600 sqm building is fully leased out and provides co-working space.

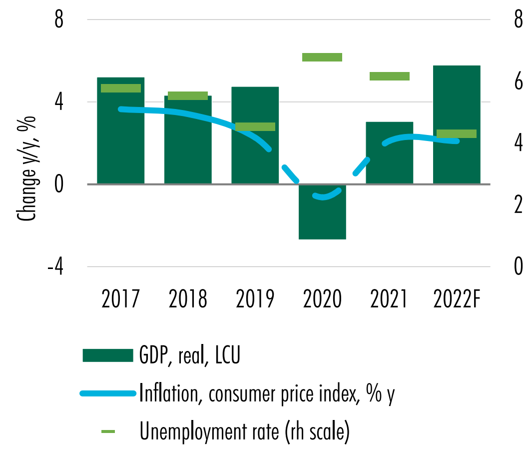
The second notable project delivered to the market was the first building in the Avala Quarter, with a leasable office space of 10,000 sqm.

One of the main reasons for the slowing of new deliveries is the continuing rise of construction costs. According to Statistics Estonia, in Q1 2021, the construction price index rose 0.7% compared to Q4 2020 and 0.5% to Q1 2020. The main reason for the rise is the increase in the costs of construction.

Like in the rest of the world, a new trend in the Tallinn office market is sustainability and eco-friendliness. At the forefront of it is Hepsor, with their already existing eco-friendly Järvevana 7b building and the soon to be commissioned Grüne and Büroo 113. Solar energy, recycled rainwater and thermo-active buildings are a few keywords characterizing their green thinking. However, they are not the only example. Kaamos opened a 24,000 sqm solar panel park in their Avala quarter, which can supply 30 per cent of the annual electricity needs of the entire business quarter.

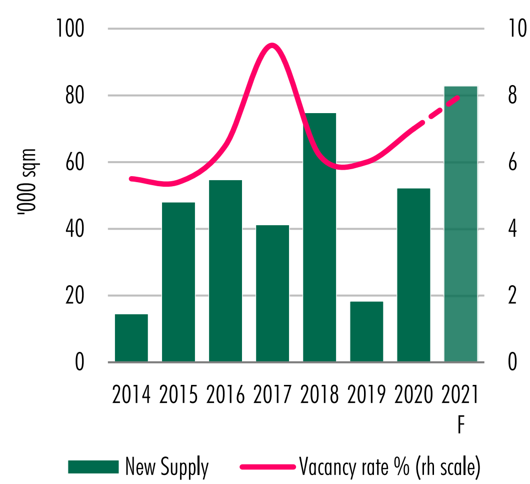
Another noticeable trend as we advance is the expansion of the new business campuses outside the city centre. With Ülemiste showing how many developers are searching for and purchasing land outside the CBD; where the land is cheaper, the continuing rise of construction prices isn't that much of a problem. Therefore, they can provide more affordable office leases as well. The best example of it is the Hipodroomi Quarter. Soon a total of 350,000 sqm of new commercial and residential spaces will be delivered. 4 office buildings with a total volume of 130,000 sqm will be opened. The most prominent tenants are Swedbank and Elisa, with their new HQ-s. The construction started in H1 2021, and the first offices are expected to be opened in 2023.

Figure 2: GDP growth, inflation, and unemployment rate



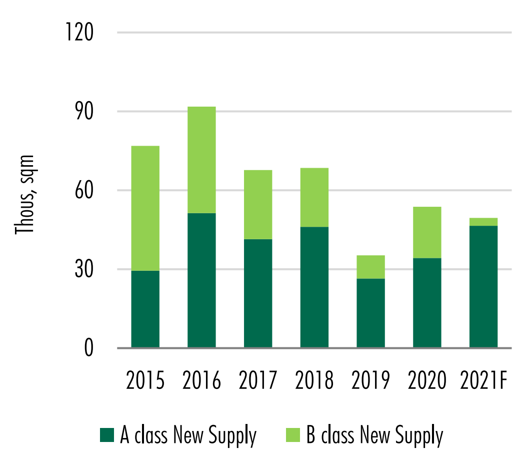
Source: CBRE Baltics, 2021

Figure 3: New supply and vacancy rate



Source: CBRE Baltics, 2021

Figure 4: New supply by office class



Source: CBRE Baltics, 2021

Merko developed Liivalia quarter with its 28,000 sqm of A-class office space, should be completed in 2024. The development is located in the CBD and will include apartments and retail space.

DEMAND

As it has been in the past, many office trends are coming to Estonia from Finland and other Nordic countries. Looking at some survey results from the Finnish market can bring some insight into the future of Tallinn's office market. In the CBRE Finland Occupier Flash Survey in September 2020, Finnish occupiers highlighted that a significant proportion of office occupiers (82%) expect to have a hybrid workplace and more flexible remote working policy in the future, up from 47% before COVID-19. According to the survey results, employees will have the option for full-time remote work in the long run (27%), at least for specific groups/teams, a policy deemed unthinkable before the pandemic (0%). This can be seen in the Estonian occupiers' market as well. According to an in-house survey made by Elisa, 69% of their workers who are already working remotely prefer to continue it.

However, 27% wish to develop a hybrid version where the week is divided between working often. This is also supported by a survey made by Palgainfo Agency and CV Keskus. According to them, 45% of the 9700 employees surveyed missed the chance to work in an office. In 2019 almost half of the office workers, who answered the CV Keskus survey, said they would like a change of work environment and sometimes like to work from home - now only 24% are saying the same. In the survey, it was concluded the 39% of people working from home would like to change their routine and work from the office instead. With many occupiers calling employees back after the summer, it is expected that demand for flexible leases and hybrid workspaces will rise.

MARKET RENTS

Market rents haven't experienced any changes in the first half of 2021. The B-class office premises' range remained stable between 12.0 – 14.0 EUR/sqm/month, with A-class prices between 15.0 – 17.0 EUR/sqm/month. With new developments in the CBD area already offering higher rents, we are expecting that in the future, rental rates for A-class buildings will increase.

Figure 5: Tallinn office market pipeline

No	Project	Developer	Class	Year	Status	GLA, sqm
1	Alma Tominga House	Mainor	A	2022	U/C	20,000
2	Tehnopol 3	Tehnopol	B1	2022	Pipeline	12,000
4	Polaris	Kaamos	A	2022	U/C	10,000
5	Rosen House	NG Invest	A	2022	Planned	8,900
6	Skyon	Capital Mill	A	2021	U/C	8,200
7	Ehitajate tee 104	EKE Invest	A	2022	Planned	7,000
8	Büroo 113	Hepsor	A	2022	U/C	3,900
9	Grüne maja	Hepsor	A	2021	U/C	3,400
10	Veerenni 38b	Fund	A	2022	U/C	3,000
11	P21	US Partners	A	2022	U/C	2,000
12	Liivalaia Quarter	Kapitel	A	2024	U/C	28,000
13	Kawe City	Kawe	A	2022	U/C	9,200
14	MaakriHUB	Fausto	A	2022	U/C	10,000
15	Park Tondi	US Invest	A	2023	Planned	6,500
					Total	**132,100**

Source: CBRE Baltics, 2021

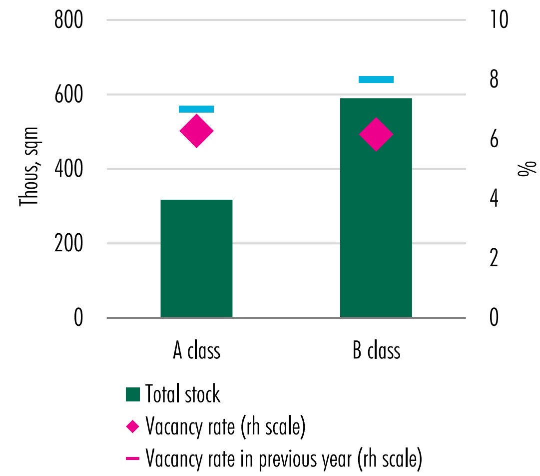
VACANCY

The B-class vacancy level is increasing , and it is expected to continue this way. The main reason is that the older buildings do not meet increasing tenant requirement for flexible space, extended services, air quality, etc., which is essential amenities for the tenants in new talent recruitment and getting the existing ones back to the office. With employees returning to offices, many tenants are searching for more high quality work space, which B-class office buildings are struggling to provide. With the incoming hybrid working solution employees are likely to require more working space and despite the rotation of workers, it is expected that the amount of office space for a tenant will increase. At the moment B-class vacancy stands at 7.2%. With the demand for A-class offices remaining stable and an efficient amount of new deliveries coming to the market, the A-class vacancy level is expected to stay in the same region. At the moment it stands at 6.2%.

INVESTMENT & TRANSACTIONS

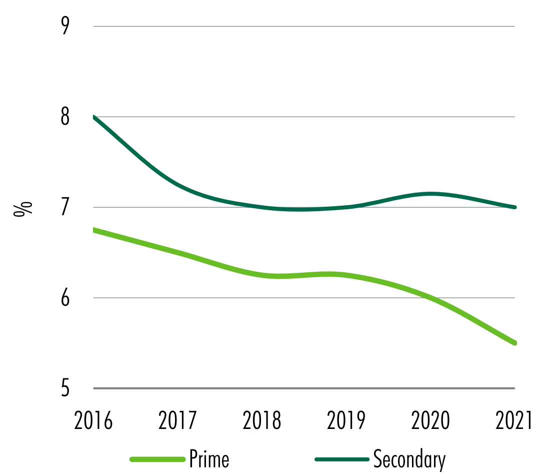
The overall office investment volume in Estonia constituted ca. EUR 15 mln in H1 2021, comprising only ca. 20% from total office investment volume in H1 2020. Almost all of the office investment value was generated in Tallinn. Office market continues to be active not only as investment properties, but also with the acquisitions of vacant possessions that could be considered as investment properties in the future. Most substantial transaction of an office building in H1 2021 was made by US Real Estate when Eften Capital sold their Kadaka Road 63 office building for EUR 8.25 million. According to CBRE's 2021 Global Investor Intentions Survey, investors are responding by directing capital to high-quality office assets providing durable long-term income streams and by intensifying their efforts to attract and retain creditworthy tenants by enhancing their amenity, wellness and flex space offerings. Also, there is a limited supply in the Baltic market for such properties. The prime yield for core properties with a long-term tenancy currently stands at 5.5%.

Figure 6: Vacancy rate by office class



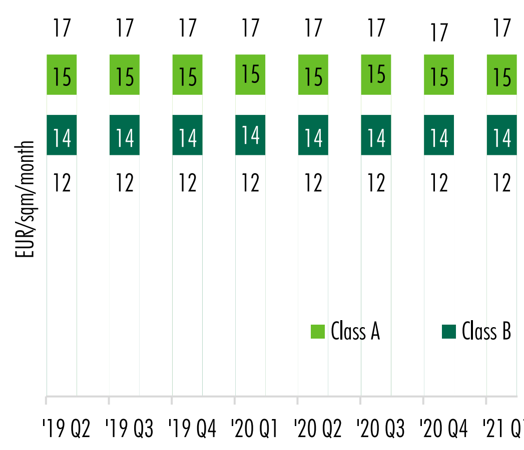
Source: CBRE Baltics, 2021.

Figure 7: Office investment yields



Source: CBRE Baltics, 2021.

Figure 8: Office rents in Tallinn



Source: CBRE Baltics, 2021

RESEARCH DEFINITIONS

Total Modern Stock – represents the total completed class A and B space (occupied or vacant) in the private and public sector at the survey date. Includes owner occupied (OO) space.

Vacant Space – represents the total net rentable floor space in existing properties, which is physically vacant and being actively marketed as at the survey date.

Vacancy Rate - represents the percentage ratio of total Vacant Space to Modern Total Stock.

Take-Up – represents the total floor space, including known to have been pre-let, sold or pre-sold to tenants or owner-occupiers during the survey period.

Prime Rent – represents the top open-market tier of rent that could be expected for a unit of standard size (commensurate with demand in each location) of the highest quality and specification and the best location in a market at the survey date. The Prime Rent should reflect the level at which relevant transactions are being completed in the market at the time. If there are no relevant transactions during the survey period, the quoted figure will be more hypothetical, based on an expert opinion of market conditions.

Absorption – represents the change in occupied stock within a market during the survey period.

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