

Adaptive Spaces

Slow but Steady Steps for Baltic Institutional Rental Residential Market

VIEWPOINT

The growing Baltic rental residential market has become more notable among institutional players. Professionally managed rental schemes drive expectations for high quality products among lessees.

CBRE BALTICS RESEARCH
MAY 2023



Rent or Buy?

It is already evident, that increased construction costs will pose challenges for developers, especially those without deep pockets in terms of available financing. The construction industry has experienced downward pressure in recent times. Initially, the covid-19 pandemic and supply chain disruptions. Furthermore, the withdrawal of Russian suppliers and products, which were major contributors of raw construction materials in the Baltic region, has further added to these challenges. In the foreseeable future, the Baltic region is expected to continue facing ongoing supply chain disruption as it competes with the Ukrainian construction market, where the demand for construction materials is rapidly rising.

These circumstances have led to increased interest in the Baltic residential rental market, with institutional investors entering the sector more confidently. Convenience, desirable location (city centres or close to transportation hubs), and higher quality offering are a few important determinants that have made rented spaces more appealing to young families in the Baltics.

Under the current market conditions, depending on the location, renting appears to be more cost-effective than buying a property. This is particularly beneficial for individuals who cannot afford the high upfront costs associated with buying a home.

Prime Rents Furnished
Apartments, 2022

Vilnius

18-21 EUR/sqm

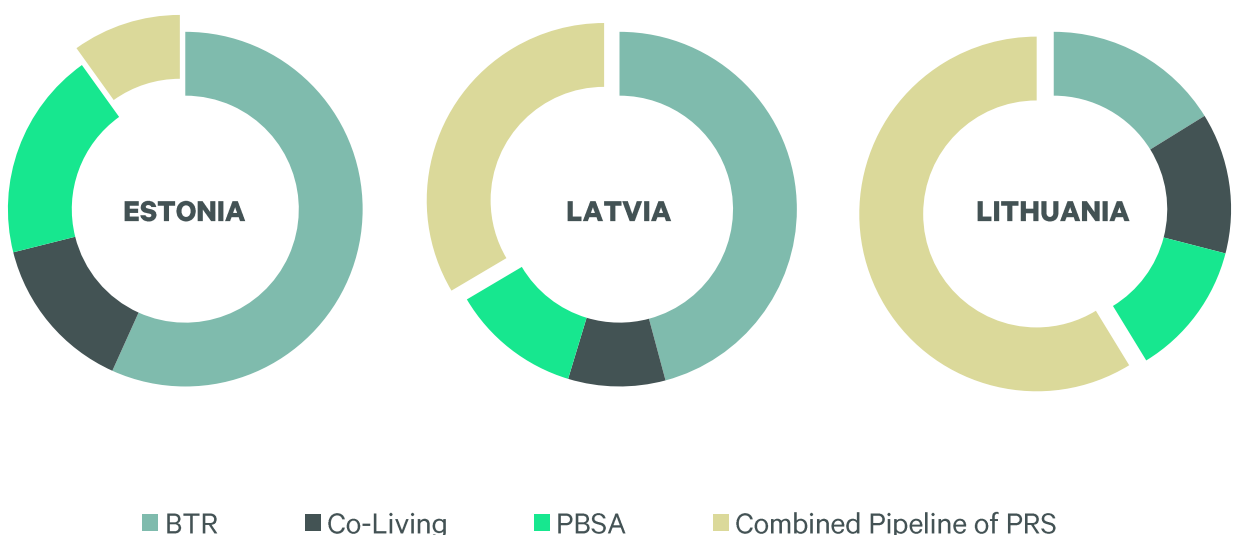
Riga

16-19 EUR/sqm

Tallinn

18-20 EUR/sqm

Current Situation in PRS Segment in the Baltics, Number of Apartments



Source: CBRE Baltics Research

Residential Sales Market

During 2022, inflationary pressures persisted in the Baltics resulting in continued upward adjustments of both sales and rental residential property prices. The rising financing costs have affected the demand for acquiring apartments. The 12-month Euribor rate has increased from negative -0.5% at the beginning of 2022 up to 3.3% at the start of 2023 (3.8% as of the analysis date), significantly putting pressure on existing loans and limiting new loan issuance. Although a decrease in newly built dwelling sales across the Baltics has been evident during late 2022 and Q1 2023, the sales of older dwellings have gained momentum. Given the current decline in residential transaction volumes, it is anticipated that the market demand for the purchasing of apartments may fully recover only in 2024.

Such market sentiment has led to the growth in residential rental market, with high demand for rentals observed since early 2022. The scarcity of quality supply and high demand has resulted in low double-digit percentage increases in rent rates compared to 2021. After a notable increase, the rent rates have softened slightly and remained stable at the beginning of 2023. This trend is expected to continue throughout the year, despite ca. 9% year-end inflation predictions across the Baltics for 2023.

The rapid increase in resource costs, particularly in fossil fuels, in 2022 has led to an increase in utility costs, including electricity and heating, among others. Despite the negative factors that may have impacted the residential market in the Baltics, both market developers and end-users have demonstrated remarkable resilience. On average, housing prices in new projects across the Baltic's increased by ca. 20% last year, while pricing in the secondary market rose by ca. 15%. In Latvia, the price for a new apartment in the city centre is EUR 3,200 per sqm compared to EUR 3,800 in Lithuania and EUR 3,750 in Estonia. For newly built apartments in secondary locations outside of the city centre, the price is also the lowest in Latvia at EUR 2,200 per sqm, while in Lithuania and Estonia, it is EUR 2,700 and EUR 2,900, respectively.

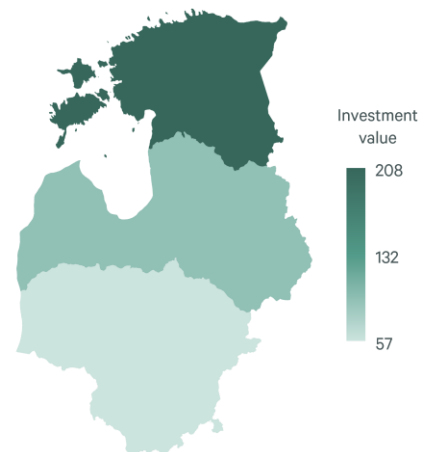
Residential Investment
Volume (sqm) in the
Baltics, 2022

26K

Residential Investment
Volume (EUR) in the
Baltics, 2022

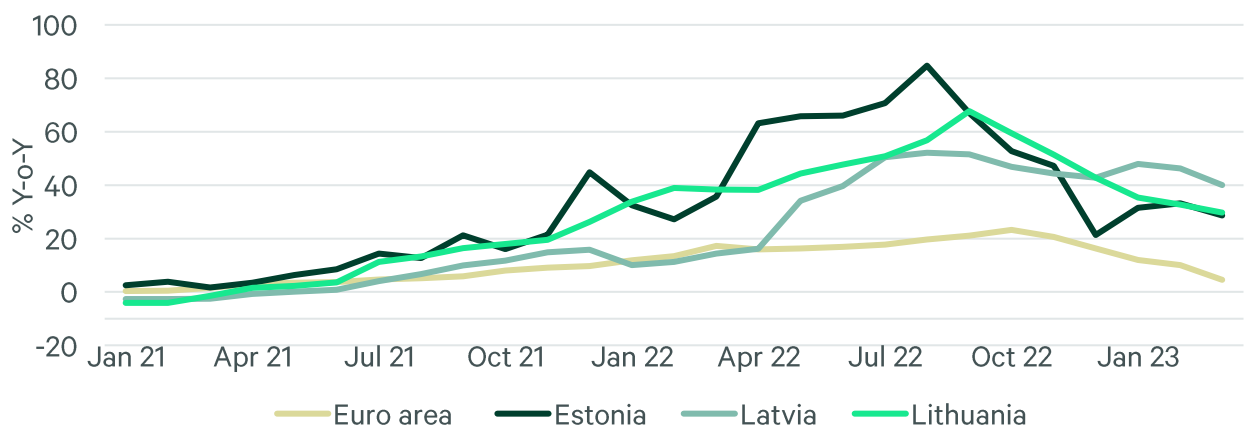
€43 M

Cumulative Residential
Investment Value (MEUR),
Baltics, 2018 – 2023*



Source: CBRE Baltics Research
*year-to-date

Utility Cost Increase in Baltics and EU/Euro Area, Annual Rate of Change



Source: Eurostat, CBRE Baltics Research

Expansion of Institutional Rental & It is Still Ongoing

The rental residential market in the Baltics is currently experiencing noteworthy activity, with a growing concentration of institutional investors. There are ongoing plans for multifamily housing developments, construction work has already begun, and new buildings are commissioned annually.

From January to June 2022, rents in the Baltics saw a steep increase of approximately 15 percent, marking one of the highest six-month rent rate increases in the the region for the past decade. However, rent growth further slowed down during the latter half of the year, and apartment rates in some locations and towns have been softening since October. While it is common to observe a decrease in rents during the autumn and winter seasons when the number of people seeking accommodation is lower, the current downward trend likely indicates a more structural change rather than just a seasonal fluctuation.

Over 1,160 apartments in the build-to-rent (BTR) schemes were delivered to the Baltic market during 2022. The largest projects include Youston by Baltic Asset Management in Vilnius (254 apartments), Aiandi Kodud by Lumi Capital in Tallinn (168 apartments), and the Katoļu kvartāls project in Riga (141 apartments). 2023 has already seen completions of such projects as Green City in Riga (84 apartments), Eften Living in Kaunas (96 apartments), and Pāevaliile in Tallinn (100 apartments), with ca. 800 apartments under construction. It is planned that about over 1,540 BTR apartments will be delivered by 2025. To put it in context, over the past three years (2020-2022) we have seen almost 1,750 new or redeveloped professionally managed apartments – similar volumes as planned in the next 3 years, showing a steadily growing alternative to the individual privately owned rental apartments.

Total Existing Stock of BTR Apartments, Baltics

4,820+

Total Existing Stock of Co-Living Apartments, Baltics

1,470+

Total Existing Stock of PBSA Apartments, Baltics

1,760+

Tallinn is the leading Baltic city in terms of the available BTR apartments. However, in the pipeline, Riga also emerges as a prominent city.

Tallinn has the highest number of available rental residential apartments in the Baltics (ca. 2,400 BTR apartments available), followed by Riga (>1,700) and Vilnius (>570). However, if we look at the pipeline, Riga emerges as the more prominent city, with almost 970 BTR apartments in the pipeline (compared to 500 in Vilnius and 170 in Tallinn).

CBRE Baltics predicts a minor shift in bargaining power from property owners to renters as a vivid trend in the rental market next year. Due to the already high apartment sales prices as well as high costs of loans, renting is expected to become a more active alternative to homeownership.. However, the trajectory of the market in the upcoming year will largely depend on broader macroeconomic conditions. In the event of a prolonged recession, there could be a meaningful decline in rents, although unlikely to reach the levels seen in 2020. On the other hand, if renters regain confidence and demand rises, rent growth could surpass expectations, especially considering indications of easing inflation and a strong labor market

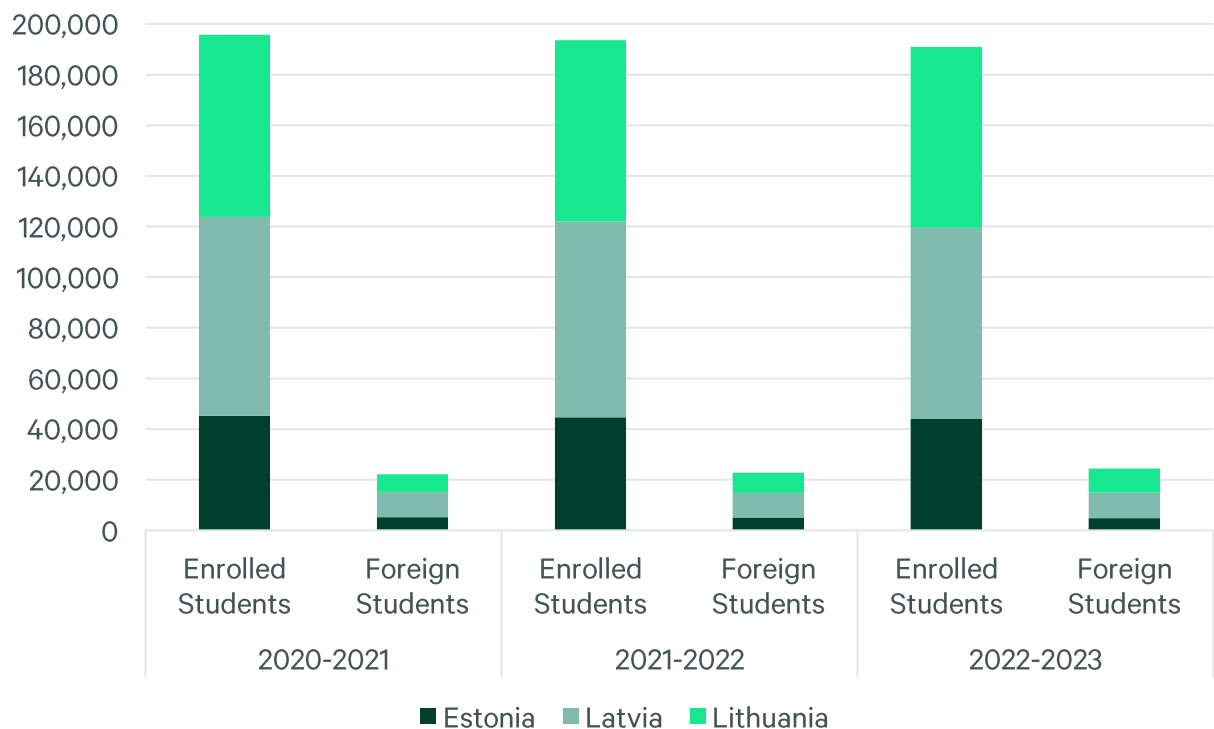
Rental Schemes for Young Professionals

Recently, confident expansion was observed not only in the BTR sector, but also among Co-Living and Purpose-Built Student Accommodation (PBSA) schemes.

Co-Living dwellings are usually not that stringent when it comes to the term of the lease, allowing both shorter- and longer-term options with respective pricing. The key competitive edge of Co-Living schemes remain the common areas for tenants to socialize. With no new Co-Living completions in 2022, the sector should expand in 2023 with four projects currently under-construction (ca.1500 apartments). In Vilnius three new deliveries are expected, namely Vytenio 46B by Eriadas, Solo Society City House Vilnius by Eika, and AeroCity by Avia Solutions Group, while the fourth expected project in 2023 is located in Tallinn – Magma Studios by Scandium. An additional five pipeline projects are at the planning stage.

The PBSA sector in the Baltics is still relatively new but has been gaining momentum in recent years, driven by the increasing number of international students studying in the region (ca. 23,000 annually throughout the Baltics). I Asset Management is one of the most active players in the sector with delivered PBSA schemes in Riga (240 apartments) and Vilnius (220 apartments) in 2022. Two new projects are in the pipeline, as Larsen constructs Heli 8 in Tallinn (94 apartments), and local developer another 300 apartment PBSA in Riga.

Number of Enrolled and Foreign Students in the Baltics



Source: National Statistics, CBRE Baltics Research

Financing Situation

Six and twelve-month Euribor rates have risen from negative territory to above the 3.5% level and rate hiking cycle of the ECB is not yet over. Markets expect the rates to rise above 4% by autumn.

Risen financing costs are impacting landlords/investors as well as renters. Owners have to pay higher interest costs to service loans. Renters are more impacted by inflationary pressure which affects communal costs, but also through owners initiating increasing rental payments.

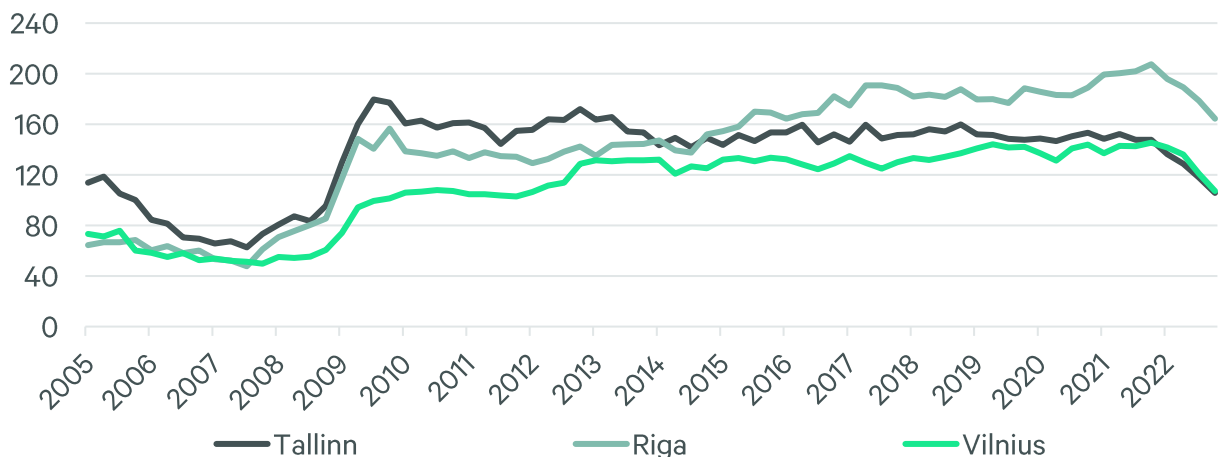
Although recent data shows that only 16% of the Baltic population choose to rent apartments, higher financing costs are pushing people, especially younger generations, towards renting vs buying an apartment. That is supporting the growth and prospects on the demand side in the PRS sector.

Percentage of Baltic Residents that Rent Apartments

16%

30% EU average

Baltic Housing Affordability Index



Source: Swedbank

Definitions

Purpose-Built Rental (PRS) is defined residential properties for rent that are held in the single ownership and are professionally managed

Build-to-Rent (BTR) refers to the purpose-built housing designed for rent rather than sale.

Co-Living is a form of purpose-built rental housing, comprising studio bedroom units and large amounts of high-quality communal space.

Purpose Built Student Accommodation (PBSA) refers to accommodation specifically designed, built or adapted for the purpose of housing students.

Contacts

Mārtiņš Grinbergs
Senior Consultant
Investment Properties
martins.grinbergs@cbre.lv

Ieva Vitaitytė
Manager
Research & Consulting
ieva.vitaityte@cbre.lt

Elza Muraševa
Senior Analyst
Research & Consulting
elza.muraseva@cbre.lv

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