



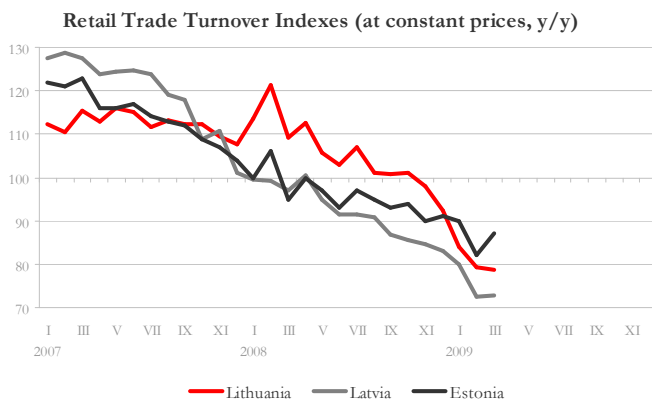
Newsletter

2009
May

Retailers and Landlords United by One Goal

Along with global economic trends, the Baltic countries entered a slowing phase in 2008. The first quarter of 2009 has brought stronger than expected GDP downturn, significant growth of unemployment, and decreasing private consumption. However, some good news are to be mentioned as well: inflation pace has slowed down, external imbalances have shrunk, and construction costs are decreasing.

The volume of retail sales keeps decreasing and the chief factors behind are tense economic conditions, lower than ever consumer confidence, decreasing salaries, rising unemployment and reasonable fear to lose one's job. Expectedly, the major drop of retail turnover was recorded in sales of electronic, household equipment, furniture, also retail sales of food products in specialized stores, meaning that consumers tend to postpone purchase of other than basic necessities. Besides, the consumption expenditure structure has already changed somewhat during 2008.



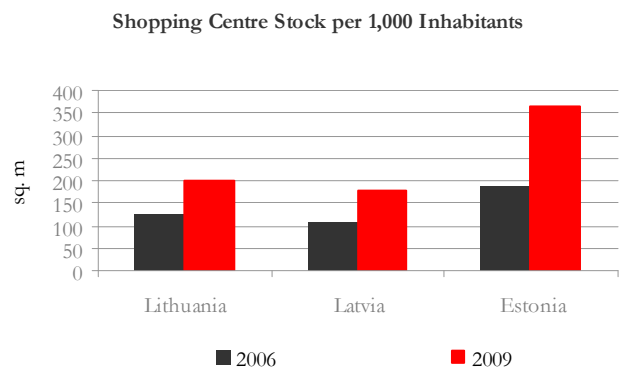
For instance, in Lithuania the consumption expenditure for food products has increased from 33.1% from total consumption expenditure in 2007 to 34.8% in 2008. Given this background, the development of the Baltic

retail market, being particularly intensive for the last few years, has recently come to a halt.

The number of new developments is significantly down

In Lithuania an optimistic number of new retail floor space was forecasted for 2009-2010 just a year ago. However, today the situation has changed and there is only one large-scale shopping centre project under construction in the whole country, i.e. Ozas Shopping Centre in Vilnius (62,000 sq. m), scheduled to be opened by the end of the year. Other planned shopping centres are postponed if not canceled, to a large extent determined by the market downturn and consequent strict lending policy by banks. Development of other type retail facilities (supermarkets, DIY stores, retail parks) has also faded owing to the same reasons.

During the first four months of 2009 one shopping centre opened its doors in Lithuania, i.e. Akropolis in Siauliai (35,000 sq. m), already the fourth shopping centre under this name in the country. Also, a new shopping gallery Herkaus Galerija (4,800 sq. m) was delivered in Klaipeda.





In Latvia, similarly, Riga Plaza shopping centre (50,000 sq. m) was opened in March, and Lība shopping centre (9,000 sq. m) opened its doors in April (in Kekava). Also a few small retail projects are ready to enter the market this year: a new shopping centre Baata (8,500 sq. m) in Liepāja and a small renovated Raibais Suns SC (3,750 sq. m) in Sigulda. One shopping centre – Galeria Patollo (38,000 sq. m) – is under construction and is planned to be completed in 2010/2011. No new shopping centres are scheduled this year for Estonia.

In general, majority of developers involved in any real estate project are forced to struggle for achieving the financial stability rather than thinking of new developments. The market is expected to start recovering when unemployment level stabilizes and begins to decrease in turn stimulating consumption recovering. Given the current economic situation, this is not forecasted earlier than in 2010.

Dramatic drop of retail sales urges market players to change their strategies

Both retailers and landlords incur serious threats to their businesses due to weaker consumer purchasing power and decreasing retail turnover.

Landlords suffer from increasing vacancy rates and tenants' insolvency thus undertake various risk management measures in order to avoid or at least reduce negative effects of the current uncertain market situation. Management of vacant space becomes crucial as the change of tenants has intensified. Also longer period is needed to find a new tenant in the vacant space.

In general, vacancy level is increasing, however it is yet not very significant in the best-performing shopping centres (reaching approx. 3-5%) due to several reasons: chain retailers tend to close only weakest retail units located in the weakest retail facilities, also in the majority of shopping centres lease contracts are rather strict, thus preventing from easy early termination. On the other hand, weaker retail facilities are forced to accept higher vacancy rates, in some cases already reaching 20-30%. Despite the fact, vacancy level is still expected to increase, even in the best-performing shopping centres.

Landlords are also worried about currency stability and review lease contracts in order to avoid negative consequences. However, the main headache is brought by tenants' requests to reduce rentals. Existing tenants are asking for rent reduction and other concessions, motivating their requests by decreasing turnovers. In fact, rentals in the best performing shopping centres have dropped by 10-20% in a year, whereas the most significant change of rentals was recorded in high streets and stand-alone retail units, in some cases up to -50% in a year.

Moreover, rentals paid only from turnover (without any basic fee) is most likely to become a usual practice in Latvia and Estonia, whereas in Lithuania this method is yet rarely used. The further change of rentals will strongly depend on the landlord's ability to be flexible. Those highly leveraged landlords will not be able to be as flexible as those who do not have to pay interests for their owned premises. Banks have already reacted to the situation by launching daughter companies intended to implement their property takeover strategies. Therefore, it is highly expected that many commercial projects will be in banks' hands, especially those properties facing the most serious problems.

On average, retailers encounter 30-50% drop in sales and are urged to optimize their business, reconsider the number of retail units as well as their optimal sizes. The worst-performing shops are being closed. Some retailers, in response to the changing needs of customers, are re-concepting their shops and targeting to lower-income buyers, compared to their usual target market. In many cases shops have been renamed to "outlets", however, not always corresponding to the very idea of an outlet. This is usually done in order to attract clients. In general, the frequency of various sales campaigns (for instance, night shopping campaigns or other events) has increased. Thus customers tend to wait for such campaigns and shop only when discounts are applied.

Already now there is a significant distinction between strong retailers, that will be able to overcome the current downturn, and weak ones that will have to give up their business. A timely reaction to the changes and flexible approach should contribute to a successful overcome of the downturn.

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