Investment Market Update
Baltic H1 2012
Waiting period

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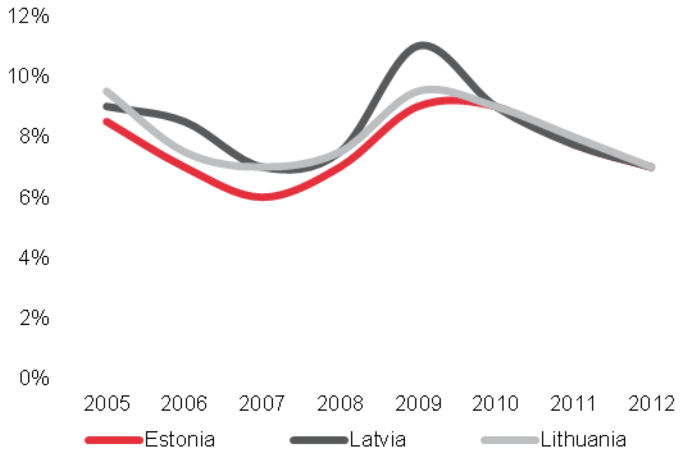
- Baltic States were leading the economic growth in the European Union, which has led to increased consumer and also business confidence, affecting the investment market in all three Baltic States positively.
- After long period of investor's inactivity, transaction volumes started to rise again in 2011 in all three Baltic States. The beginning of 2012 has shown the continuing activity and H2 2012 is even more promising, when several investment transactions should be finalized.
- Private investors dominate the investment market in Latvia while different investment funds are continuously increasing their portfolio volumes in Estonia and Lithuania.
- Several transactions were held in H1 2012 in Baltics, e.g. investment funds have shown the interest in retail properties in Baltics. Retail sector accounted the majority of all the investment transactions.
- Yield levels are continuously decreasing, being still relatively high compared to Northern and Western Europe. The levels are rather similar among all three Baltic countries, even more emphasising the essence of united investment market.

Figure 1

Dynamics of retail prime yields in Baltics



Source: DTZ Research

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Macro-economic trends

Estonia

As the export capacity has decreased since the end of Y2011, the domestic demand is playing the main role in Y2012's economic growth of Estonia. The consumer confidence has increased and the risks from European economy have not had that great impact to Estonian economy as firstly expected. Bank of Estonia has also increased the forecasted figures of economic growth for 2012 in their last report. Nevertheless, if the situation in Europe will turn more serious, then the economic decrease is expected also in Estonia, meaning that the risks are still there and considered with.

Based on the information presented by Bank of Estonia and Statistics Estonia GDP increased by 7.6% in 2011. Before that GDP decreased by 14.3% in Y2009 and was followed by 2.3% increase in Y2010. Based on the prognoses of Estonian Bank (from June 2012) the growth of GDP will be 2.6% in Y2012, 3.6% in Y2013 and 4.1% in Y2014. The growth of GDP was 3.7% in the Q1 Y2012 compared to the same period in 2011. In the comparison with Q4 Y2011, the growth was 0.3%. So the tempo of the increase has clearly slowed down.

Based on the information from Bank of Estonia and Statistics Estonia, the CPI growth was 5.0% in Y2011, 2.7% in Y2010 and 0.2% in Y2009. Such fast inflation is mainly caused by price increase in food and fuel sector, but also because of increased household costs. Based on the prognoses of Bank of Estonia, the CPI change will be 3.9% in Y2012, 3.2% in Y2013 and 2.7% in Y2014.

The average registered unemployment rate was 12.3% in 2010. Same figure has continuously decreased, being averagely 8.4% in 2011 and 7.6% in Q1 Y2012.

Latvia

Latvia's economic growth in Q1 2012 was the fastest in the EU year-on-year and the fastest quarter-on-quarter. Compared to the 1st quarter of 2011, GDP in the 1st quarter of 2012 has increased by 6.9%, according to seasonally non-adjusted data of the Central Statistical Bureau of Latvia. Whereas according to seasonally adjusted data, GDP in Q1 2012 has risen by 1.1%, as compared to the 4th quarter of 2011.
Historically, from 1996 until 2011, Latvia's average annual GDP growth was 4.54% reaching a historically high level of 13.90% in March of 1996 and a lowest level of -19.10% in September of 2009 according to the data of the Central Statistical Bureau of Latvia. Stronger export and restocking has stimulated investments and import in 2011. GDP prognosis for 2012 is at 2.5 -3% level. Latvia's GDP growth in 2012 will of course be dependent on development of global economy.

The annual average consumer price increase in 2011 was 4.4%. In Q1 2012, the annual inflation continued to drop, with its drop within a month, 0.5pp to 2.8%. The rise in inflation was held down by a high unemployment rate and relatively low consumer purchasing power. Overall, it is anticipated that the consumer price rise will stand at 2.4% in 2012; however, the risks to the forecast are on the upside. In 2013, inflation is projected close to 2%.

The labour market situation has continued to improve. In December 2011 11.5% of the active population of Latvia were unemployed. At the beginning of 2012, the registered unemployment rate was on a rise again and the overall unemployment will still remain comparatively high for the next few years. Further developments will depend on the amount of new workplaces, productivity and wage growth.

Overall economic activity indicators are better than expected for the first months of 2012, this gives hope that the overall annual growth figures for the year could also turn out to be better than initially planned.

Lithuania

The economic growth has been higher compared to the expectations. However, the GDP growth in has slowed down compared to previous period.

Statistics Lithuania informs that real GDP growth rate in 2011 was 5.9%, and was followed by 1.4% increase in 2010. In Q1 2012, GDP at current prices amounted to €7,3m and, against the same period in 2011, its growth (real) stood at 3.9 %, while against Q4 2011 it dropped by 7.3 %.

Average annual inflation rate was 4.1% in 2011 and it increased, compared with corresponding previous year, by 3,4 times. Annual inflation still remains quite high. In

May 2012, average annual inflation calculated by Statistics Lithuania based on the harmonised index of consumer prices (HICP) stood at 3.9%.

According to the information from Statistics Lithuania, the unemployment rate in the country in 2011 was 15.4%. Compared with 2010, it decreased averagely stood at 13%. According to the Labour Force Survey data, the unemployment rate in the country in Q1 2012 stood at 14.5%, which is by 0.6 percentage points more than in Q4 2011.

The Bank of Lithuania is projected that the real GDP of Lithuania will increase by 3.0% in 2012 and 3.5% in 2013. Annual inflation is expected 2.9% in 2012 and 2.7% in 2013. Also it is forecasted that unemployment will decrease quite slower in 2012 and 2013 – respectively by 1.2 per cent and 1.3 per cent.

Table 1

Key Macroeconomic Indicators

	Estonia	Latvia	Lithuania
Population (in thousands)	1,318	2,075	3,245
Urban population	66%	68%	67%
Area (thousand km²)	45	65	65
Population density (per km²)	31	32	50
Capital city	Tallinn	Riga	Vilnius
Population in capital cities (thousand)	402	706	554
Currency	EUR	LVL	LTL
Exchange rate (€)	x	0,7028	3,4528
GDP at current prices (bn €, 2011)	15,97	20,15	31
GDP per capita, at current prices (€, 2011)	12119	9712	9464
GDP growth (%, 2011)	7,6	5,5	5,9
Inflation rate (%, 2011)	5,0	4,4	4,1
Unemployment rate (%, 2011)	12,5	15,4	15,4

Source: National Statistics, Oxford Economics

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Investment market
Estonia

In Estonia the investor's interest is mainly addressed towards the properties located in capital city Tallinn, but in smaller amount also towards other larger Estonian cities like Tartu, Pärnu, Jõhvi and Narva. The rest of Estonia even in larger settlements is less valued from an investment point of view.

Transactions

Activity in investment market enlivened from second half of 2009 onwards, and even more from Q2 2010, being active throughout 2011. If in 2009 office properties were sold with the yield approximately 10% and higher, then properties sold during 2011 had yields around 8.5%, so the overall investment market situation has improved significantly.

Total investment volume exceeded €140m level in Y2011. There were following larger transactions made:

- Q2 2011, Citycon bought Kristiine shopping centre with €105m (yield level 8.0%);
- Q2 2011, BPT bought Lincona office complex with €15.4m (yield level 8.5%);
- Q2 2011, EfTEN bought office building sized approximately 3,500 sq m in Tartu city centre with €2.25m;
- Q4 2011, EfTEN bought two office buildings on the edge of city centre with €18.5m (yield level 8.5%).

In H1 2012 first transaction in industrial sector was completed over a longer period of time when East Capital bought VGP Warehouse Park located in Tänassilma industrial park near Tallinn city border. The size of the logistics centre is 40,000 sq m and the transaction was made on the level of €24m, the yield level was above 9%.

Although the beginning of Y2012 has been rather inactive, the overall investment capacity of Y2012 is estimated on €100m level. Couple of larger investment funds have reached to their selling periods and hopefully will successfully close some deals. Extra for that one historically high investment transaction is estimated to take place in retail sector.

Yields

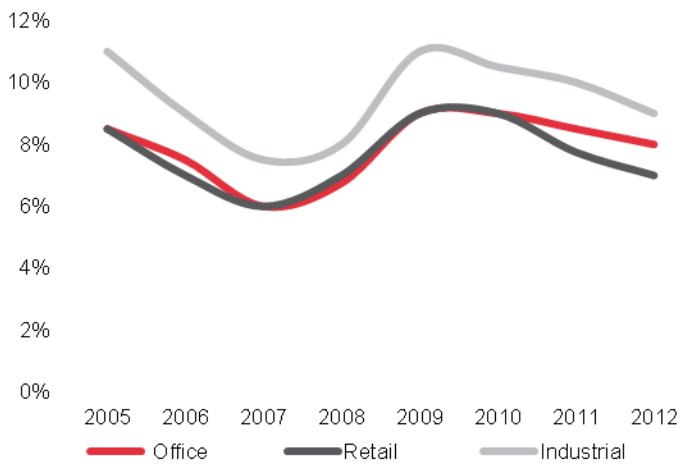
Compared to Northern and Western European countries, market yields in Estonia have been relatively high. During the years 2006-2007, the yields and interest rates fell dramatically, almost to the level of Northern and Western European countries. During the years 2008 -2009, yields rose again - during 2008, the increase was 150-250 basis points and during 2009, 50-100 additional basis points. In 2010 the yields remained quite stable. The year 2011 brought first signs of decrease in retail and office sector by 50-100 basis points and the beginning of 2012 also in industrial sector by 100 basis points. There is a continuous pressure towards lower yields, so most probably there is an extra room for drop in amount of approximately 50 basis points in 2012.

The "low end" of yields in industrial and logistic investment sector starts from 9.0% on the condition that an investment has good quality, a long term rental agreement (usually sale & lease-back deals), a trustworthy lessee and a guarantee from a bank or from subsidiary company. The lowest yield for retail is 7.5% and for office properties 8.0%.

Yields in Pärnu and Tartu are 1-3% higher, depending on quality and perspective of the property. The yields are significantly higher in other parts of Estonia and not comparable even in more populated settlements.

Figure 2

Yield dynamics in Estonia



Source: DTZ Research

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Latvia

General overview

Investment demand is growing for retail properties as situation in this sector continues to improve. Demand for other real estate segments still remains rather low in Latvia. Property performance improved, especially in retail sector. Occupancy rate, rental levels and retail trade turnover grew in 2011.

Transactions

During H1 2012 several transactions took place. Retail properties were involved in the majority of deals, except residential projects. The most recent transaction took place between STC Imanta, SIA and HipoFondi, AS; shopping centre Imanta was sold in Jan 2012, Lattelecom, SIA and United Estate, SIA; office building at Brivibas street 33 was sold in Mar 2012, private person and Smilsu iela 16, SIA; office building in Old Town was sold in Feb 2012. Total transaction volume of mentioned above extends to 10.5 m €.

It is typical today that the acquisition process is longer as buyers allow more time for a thorough examination of the assets and are not keen to quick moves because of the external economic factors. Accordingly we expect a number of deals that were initiated in the beginning of 2012 or even the last quarter of 2011 to be finalized in H2 2012 or H1 2013.

On the 1 July 2010, the amendments to the immigration law of Latvia came into effect, which allow foreign investors to obtain the residence permit in Latvia. This legislative change was expected to have serious impact on Latvian investment market. During the last two years total amount of investments reached €215m. The average figure of deal varies from €150 000 to €200 000. Residential property is the most majority. More active purchasers are mostly private persons from Russia and CIS countries; even from China.

The purpose of an investment transaction is market speculation or own usage, but not purchasing cash flow generating objects. These types of deals are mostly speculative or distressed with small deal size between €2m and €10m.

Foreign investors show great interest in investments in Latvia; they are interested in acquisition of assets with a long-term outlook for a low price, as well the purchase of competitors' companies. The properties on sale in H1 2012 are mostly portfolios of retail properties, small office buildings, and soviet-era industrial buildings in secondary location. The recent trends mark supply of new development projects that are offered in the market more often. Some more serious transactions are foreseen in the H2 2012. Almost no demand for industrial/ logistics properties in Latvia.

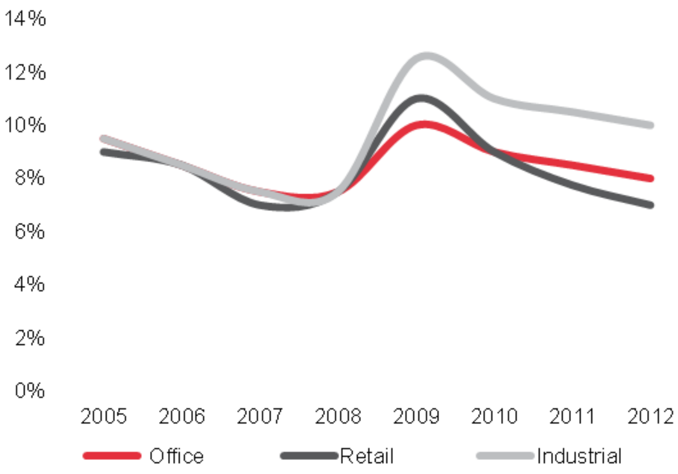
Yields

Market yields in Latvia have historically been relatively high compared to Northern and Western European countries. During the years 2006/07 the yields fell sharply, however, during the years 2008/09 - 2009/10 yields quickly increased again. The first signs of commercial market stabilization were noticed in 2010, rental rates have evened out and stopped falling, and investors' increase in confidence has resulted in lower yields.

The lowest level of yields in the industrial and logistics sectors start at 10.0% on the condition that an investment is good condition with long term rental agreement (usually sale & lease-back deals), a good quality tenant and a guarantee from a bank or from mother company. The prime yields for retail and office objects are 7.0% and 7.5%, respectively, slightly lower than in HY2 2011.

Figure 3

Yield dynamics in Latvia



Source: DTZ Research

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Lithuania

General overview

In Lithuania, the favourable regions for international investors are Vilnius, Klaipeda, and Kaunas.

During Q2 2012 shopping centres` rental levels were stable and did not increase. Office market was stable also in the first half of 2011. Industrial segment is stable.

Transactions

The most active part of investment market is involved with retail and industrial properties because those are more stable market sectors. In 2011 there were two biggest transactions:

- Q4 2011, Swedbank Ektornet Lithuania purchased SC Gedimino 9 for EUR 23 million.
- Q4 2011, Finnish company Pontos group purchased SC Babilonas in Panevezys for EUR 24 million.

There are no major investment transactions in Q2 2012.Total commercial property investment volume was ca €85m.
The Scandinavian investors have dominated in Lithuanian investment market. Lords LB Baltic Fund ("Lords LB Asset Management" is a licensed fund management company supervised by the Bank of Lithuania). EUR 50 million fund Lords LB Baltic Fund III, established in May 2012. The fund is only for professional investors seeking for a capital gain from investments into real estate objects over a long period and able to tolerate higher than long-term medium risk. The minimum invested amount is EUR 50,000, and restrictions are applied for the sale and redemption of the distributed investment fund units.

German and Netherlands capital investments were most active in Lithuania in 2011.

German investments in real estate activities were 29% from all foreign direct investment in this sector and Netherlands 21% during the 2011 period. Other most active country was Sweden.

The most active investors in Lithuanian market are small local players. The real estate fund BPT Secura A/S was the most active vendor. The sale of BPT Secura A/S property portfolio is still on the process. Also, small local players have tried to sell their properties, like shopping Centre ''Geras'' in a small city of Elektrenai. There is one local investor that is interested in this property only.

Yields

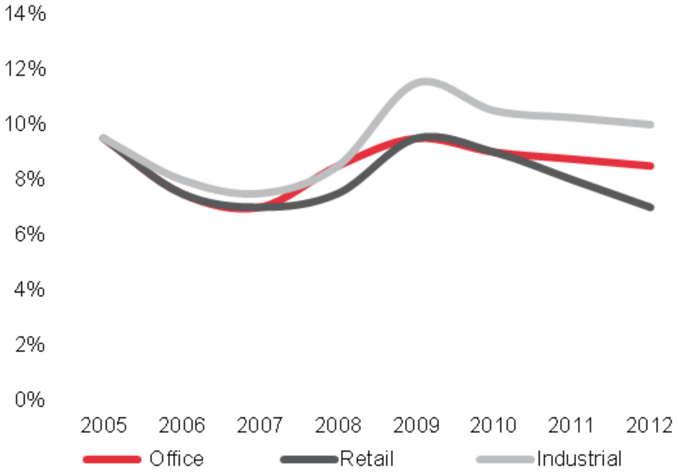
Due to a small number of transactions and no evidence of cash flows from properties sold in 2012, the yields are representing the overall expectations.

The expected prime yield level currently stands at 8,5% for office properties. The yield for retail properties is 7.75%, while that of industrial real estate starts at 10.00%.

Prime yields are expected to be stable in 2012.

Figure 4

Yield dynamics in Lithuania



Source: DTZ Research

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Specialised real estate funds in Estonia, Latvia and Lithuania

Situation in Baltic investment market has strongly recovered from the end of 2010. Interest towards Estonian investment opportunities has been highest, but the situation has improved also in Latvia and Lithuania.

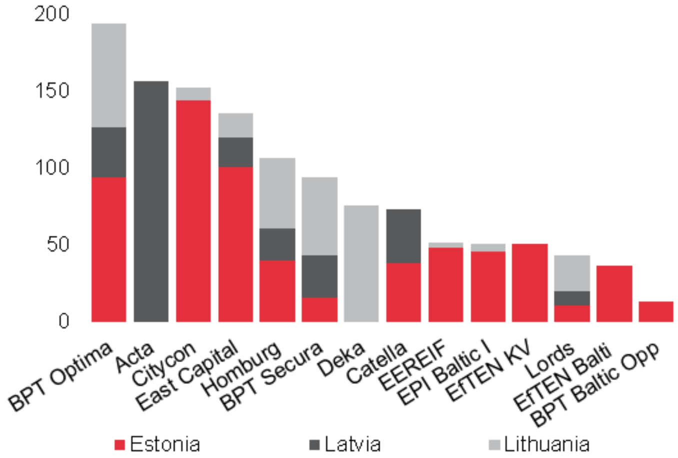
Baltic property investment market is dominated by investors from Nordic countries (Denmark, Norway, Sweden and Finland), but there are also investors with German, Russian and Canadian background. The largest investment funds by the size of the objects are owned by BPT, Acta, East Capital and Citycon. By activity currently BPT and East Capital are more distinguished from named funds.

By total portfolio values the largest funds are Citycon (owning 3 shopping centres in Tallinn, Estonia and one in Vilnius, Lithuania), Homburg (owning previous SEB fund containing bank offices all over Baltic countries), shopping centres' owner in Lithuania – Deka and shopping centres' owner in Latvia – Acta. BPT currently manages three real estate investment funds containing different properties all over the Baltics.

In Estonia, first national capital based investment fund was founded in 2005 – Eastern European Real Estate Investment Fund (EEREIF) and the second in 2008 - Eften Capital, which operates two different portfolios, containing commercial properties all over Estonia. EEREIF portfolio contains different typed objects in all 3 Baltic countries and also in Poland and Bulgaria. This kind of a national investment fund was also created in Lithuania, however, slightly later – Lords LB, which operates already with five different portfolios.

Baltic countries separately are small in size, but together make a considerable region for trade and investment. All three countries are effective in the speed of decision making with country-wide importance, making them more stable and trustworthy partners in long term. Due to low wage level, the countries are attractive to international industries in order to increase the efficiency of their operation. In addition, the Baltic countries have strong growth potential in terms of real estate market and participating in global transit and industry.

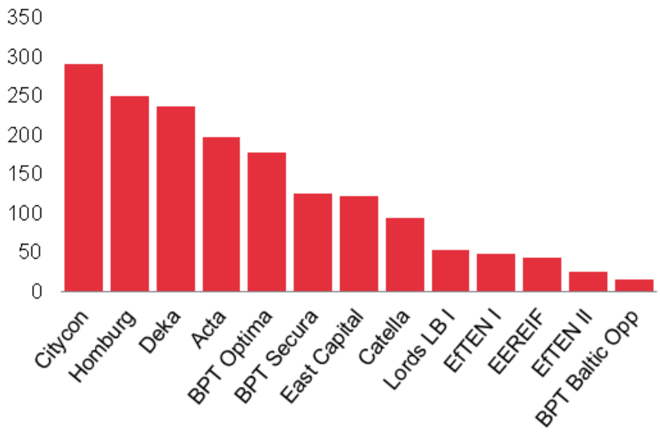
Figure 5
Current portfolio volumes by size in Baltics in 2012, 000 sq m



Source: DTZ Research

Figure 6

Investment Fund`s total portfolio value in Baltics, € m



Source: DTZ Research

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