INVESTMENT MARKET UPDATE

Yield compression continues

Baltic States Q3 2015

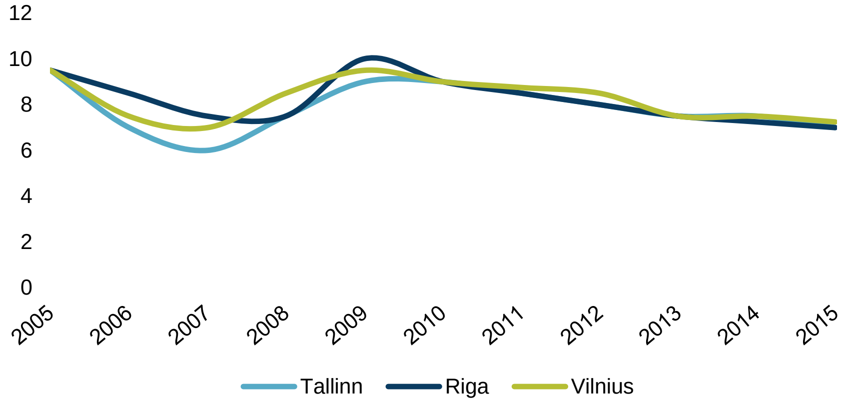
19 October 2015

Contents

- The overall market turnover in Q1-3 of 2015 in the Baltic region was around €500 M. The directions that the capital flow undertakes in the three countries, however, are very different.
  - In Estonia, the biggest share of market turnover is generated by a number of local institutional players, who are actively expanding and diversifying – location-wise, segment-wise, and risk-wise – their portfolios. The average lot size per asset is around €10-15 M; the market, however, is dominated by portfolio deals that simultaneously involve a number of assets.
  - In Latvia, the biggest share of market turnover is generated by the institutional entrants from the two neighbouring countries, and by private capital inflow from Russia and other CIS countries. The average lot size per asset is around €5 M; portfolio deals are less common.
  - In Lithuania, almost one-third of the annual market turnover was generated by a single asset deal with a buyer coming from the Nordics. The lion share of the remaining turnover involves participation of the local asset management company Lords LB.
- Pan-region wise, the most active purchasers are Estonian EfTEN Capital, Capital Mill, Partners Group and Colonna Capital.
- Asset-wise, the interest was mostly geared towards the office and retail segment in all three Baltic States. At the same time, each of the countries accommodated a number of deals with medium to large-sized industrial assets.
- The estimated investment volumes for all of 2015 are similar to those generated in the first half. The interest is expected to be mostly geared towards retail and office segments.

Figure 1

Office yield dynamics, %



Source: DTZ Research

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General overview

In all three Baltic countries the investor's interest is mainly addressed towards the properties located in capital cities. Tallinn (435k inhabitants) in Estonia, Riga (643k inhabitants) in Latvia and Vilnius (540k inhabitants) in Lithuania are accordingly the biggest in every country and those are also three biggest markets in the Baltic region. The situation in Lithuania differs compared to Estonia and Latvia as Lithuanian secondary cities have some more significance. There are at least two other remarkable secondary cities in Lithuania: Kaunas (325k inhabitants) and Klaipeda (160k inhabitants). The other secondary cities (Tartu (97k inhabitants) and Pärnu (41k inhabitants) in Estonia, Daugavpils (101k inhabitants), Liepaja (75k inhabitants) and Ventspils (42k inhabitants) in Latvia and Siauliai (129k inhabitants) and Panevezys (114k inhabitants) in Lithuania are attractive from an investment point of view only in the context of bigger retail objects. The remaining cities can be attractive only in the context of some bigger retail portfolios.

The largest portfolios in Estonia belong to Northern Horizon Capital (previously operated as Baltic Property Trust), East Capital, Citycon, Colonna Capital, Partners Group, Sveafastighet, Geneba, EfTEN Capital, Capital Mill and Zenith Capital.

Based on the number of units, the bank's real estate companies are still the biggest owners in Latvia but their portfolios consist mainly of apartments and residential development projects, the number of properties decrees continuously. The most active investors are East Capital, Partners Group, EfTEN Capital, Capital Mill, Hili Properties and private investors from Russia.

Biggest portfolios in Lithuania belong to Northern Horizon Capital, East Capital, Partners Group and Lords. Estonian-based Capital Mill and Zenith Capital have shown their interest but they have not made any investments so far. New local investment management companies Prosperus Real Estate (Lithuania) and United Asset Management (Estonia) entered the market accordingly in 2014 and 2015.

The funds operating in the Baltics are mainly from the Nordics and part of those operates in all three Baltic countries. Local investors are more active and it is especially related to EfTEN Capital. There is also growing interest from Russia, which is affected by the Russian crisis and is driven by private investors.

Transactions

Q1 2015

• EfTEN Real Estate Fund acquired full ownership of the Radisson BLU Sky hotel's real estate in Tallinn and a hotel operator company, Astlanda Hotelli AS, for €46 M. In addition to the landmark hotel Radisson Blu Sky, EfTEN Real Estate Fund II also acquired a 3000 sq m office building and the Madisson pub, which are a part of the same property.

• Colonna investors acquired a new 14-storey office building located at Lelle Street 22 in Tallinn, and the main lessee is the state-owned energy company Eesti Energia AS.

• The investment company 139 Pärnu Road OÜ acquired the office property at Pärnu Road 139, Tallinn in the periphery of the Central District. The long-term lessee of the building is the Police and Border Guard Board. The transaction price was €27 M.

• Partners Group and its operating partner Northern Horizon Capital acquired a real estate portfolio held by BPT Optima in the Baltic States and Poland for €163 M. The transaction marks the largest real estate investment into the Baltics in the post-crisis period. The deal includes seven office and retail properties in the Baltics, totalling 112,000 sq m of leasable space: the Hobujaama 4 and Valge Maja office properties and the Vesse SC in Tallinn, the Vertas SC in Vilnius, the Molas SC in Kaunas, the BIG SC in Klaipeda, and the Olimpia SC in Riga. The acquisition also includes the Young City development project in Gdansk, Poland.

• East Capital signed an agreement to acquire the Mustamäe Centre under construction located at A.H. Tammsaare Road 104a, Tallinn. The details of the deal will be published after conclusion of transaction.

• EfTEN Capital acquired office property at Lāčplēša Street 20A, Riga with a transaction price around €9 M.

• Hili Properties acquired the retail portfolio dominated by Rimi anchor tenancy. Portfolio consists of nine properties in Riga, Daugavpils, Tukums and Aizkraukle. Rimi will remain a long-term lessee of all those properties.

• Baltic Opportunity Fund acquired 22,600 CGA sq m Europa SC in Vilnius.

Q2 2015

• A local development company, Hanner, acquired a 76,000 sq m land plot (previously used as a football stadium) in the relative centre of Vilnius for €40 M.

• Colonna acquired Rimi's discounters and supermarkets portfolio consisting of 18 properties (five in Tallinn and the rest mainly in relatively small Estonian cities). Rimi will remain a long-term lessee of all those properties. The transaction price was €17.2 M.

• Crowdestate, an Estonian kickstart company, sold a warehouse property in Tallinn's vicinity at the address Kesk Road 17, Jüri. No information about the buyer. The selling price was €3.2 M.

• Norwegian investor Selvaag sold two industrial (warehouse)-office properties in Tallinn's Lasnamäe district at the addresses Peterburi Road 47 and 49. No information about the buyer. The selling prices were accordingly €3.4 M and €4.2 M.

Q3 2015

• The investment company PBG Holding Invest acquired the office property at Pärnu Road 139, Tallinn in the periphery of the Central District. The property was reselled after ca 6-month holding period. The long-term lessee of the building is the Police and Border Guard Board. The transaction price was €33 M.

• EfTEN Real Estate Fund III acquired the Saules Miestas shopping centre at the address Tilzes 109, Šiauliai from E.L.L. Kinnisvara. The transaction price was €30 M.

• Capital Mill bought two properties with Rimi as anchor tenant – Kr.Valdemara Street 62A, Riga with transaction price €7,8 M and Tilta Street 32, Riga with transaction price €1,8 M. Vendor of both properties was LNK Properties.

• Marno J acquired one of the biggest buildings in Riga centre from Ektornet portfolio with address Brīvības Street 88. Transaction price was €4,5 M.

Yields

Compared to Northern and Western European countries, market yields in the Baltic countries have historically been relatively higher. 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 and much more dramatically compared to the countries with matured markets. The yields remained quite stable in 2010. The year 2011 brought the first signs of a decrease in the retail and office sector by 50-100 basis points and the beginning of 2012 in the industrial sector as well by 100 basis points. Starting from the second half of 2012 the yields remained relatively stable until the end of 2014. H1 2015 can be characterised by yield compression in all sectors. Those changes have been mainly affected by external influences as the crisis in Russia, which has motivated Russian investors to invest abroad and ECB money printing, which was one of the main reasons for yield compression not only in the Baltic region.

The lowest yields in the industrial and logistics sectors start from 8.0%. In this case the building should be in good condition, there should be a long-term rental agreement (usually sale & lease-back deals), a trustworthy lessee and a guarantee from a bank or from a parent company. The lowest yield for retail is 6.5-7.0% and for office properties 7.0-7.5%. The number of sales has been limited and there are even more limited numbers of sales that can be used as benchmarks in the context of yield estimation. The Rimi distribution centre in Tallinn's vicinity was transferred at a yield rate 8.0% in Q3 2014. The Hanza Mechanics, Mediq and Stora Enso portfolio in Tallinn's vicinity was transferred at a yield rate 8.2% in Q4 2014. Kesk Road, Jyri logistics centre (Tallinn's vicinity) was transferred at a level of 8.0% in Q2 2015. The situation in the office and retail sectors in the sense of data availability is quite similar. The Metro Plaza office property in Tallinn was transferred at a yield rate of ca 7.0% in Q4 2014. Again, it is the upscale property even within the CBD area and the yields starting from 7.2% still characterise the market in general. Europa SC in Vilnius was transferred at a yield rate below 7.0% in Q1 2015. Several transactions not mentioned above have been made on those frames. Danske Bank office building, Mandarinas SC, Verslo Uostas office building in Vilnius can be added as examples. The yields in the retail sector vary as the sales of bigger portfolios including properties in secondary cities can be at a level of ca. 9.0%, at the same time the retail properties in CBD can be at a yield rate of 6% or even lower.

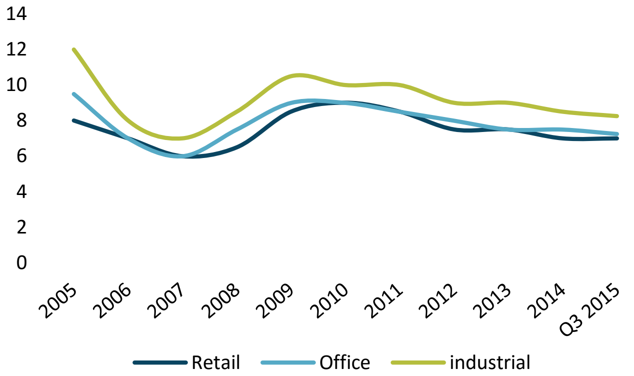
The yields in secondary cities are 0.5-3.0% higher, depending on the location, quality and perspective of the property.

Forecast

The yields have been compressed during Q1-3 2015 and the same trend will continue. The main interest will be related continuously to capital cities Tallinn, Riga and Vilnius. Lithuanian secondary cities Klaipeda and Kaunas will be more attractive compared to all other secondary cities. The other secondary cities can raise interest mainly in the context of retail properties and/or part of a bigger portfolio.

Figure 2

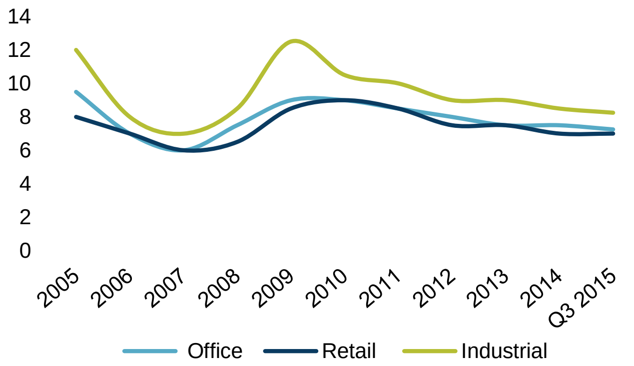
Yield dynamics in Tallinn, %



Source: DTZ Research

Figure 3

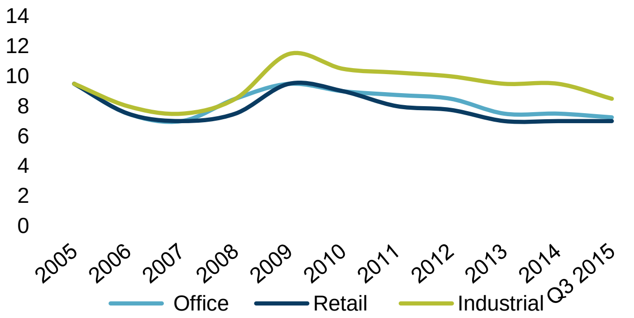
Yield dynamics in Riga, %



Source: DTZ Research

Figure 4

Yield dynamics in Vilnius, %



Source: DTZ Research

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